MISSISSIPPI LAW JOURNAL

THE MEMORIAL LECTURE SERIES — 1982

DEFINING THE ROLE OF THE VICTIM IN CRIMINAL PROSECUTION

Abraham S. Goldstein

ARTICLE

A SURVEY AND ANALYSIS OF COMPARATIVE FAULT IN MISSISSIPPI

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The 1982 Mississippi Law Institute will be held at the Coliseum Ramada Inn in Jackson on December 3 and 4, 1982. The meeting will be the 37th Mississippi Law Institute and the topic this year is Oil and Gas Law. Guest speakers include practicing attorneys as well as noted law school professors. Several specific areas of Oil and Gas Law will be discussed with emphasis placed on Mississippi law.

Guest speakers include Fred C. Luce of Mobil Exploration Company; Martha W. Gerald of Jackson, Mississippi; Kenneth I. Franks of Jackson, Mississippi; Thomas A. Harrell, Director of the Mineral Law Institute and Professor at Louisiana State University Law School; and John M. Grower of Jackson, Mississippi.

Also on the program are Phillip E. Norvell, Assistant Professor of Law at the University of Arkansas School of Law and Wilbur K. Knight, and independent consulting geologist in Jackson, Mississippi.

Admission to the Institute will be $80 for persons who pre-register and $90 for persons who register at the door. The admission fee includes a bound copy of the proceedings. Copies of the proceedings will be available for $35 to persons who cannot attend the Institute.

Further information about the Institute may be obtained by writing George Woodliff, III, Suite 1030, Capital Towers, Jackson, Mississippi, 39201.

Mississippi Law Journal

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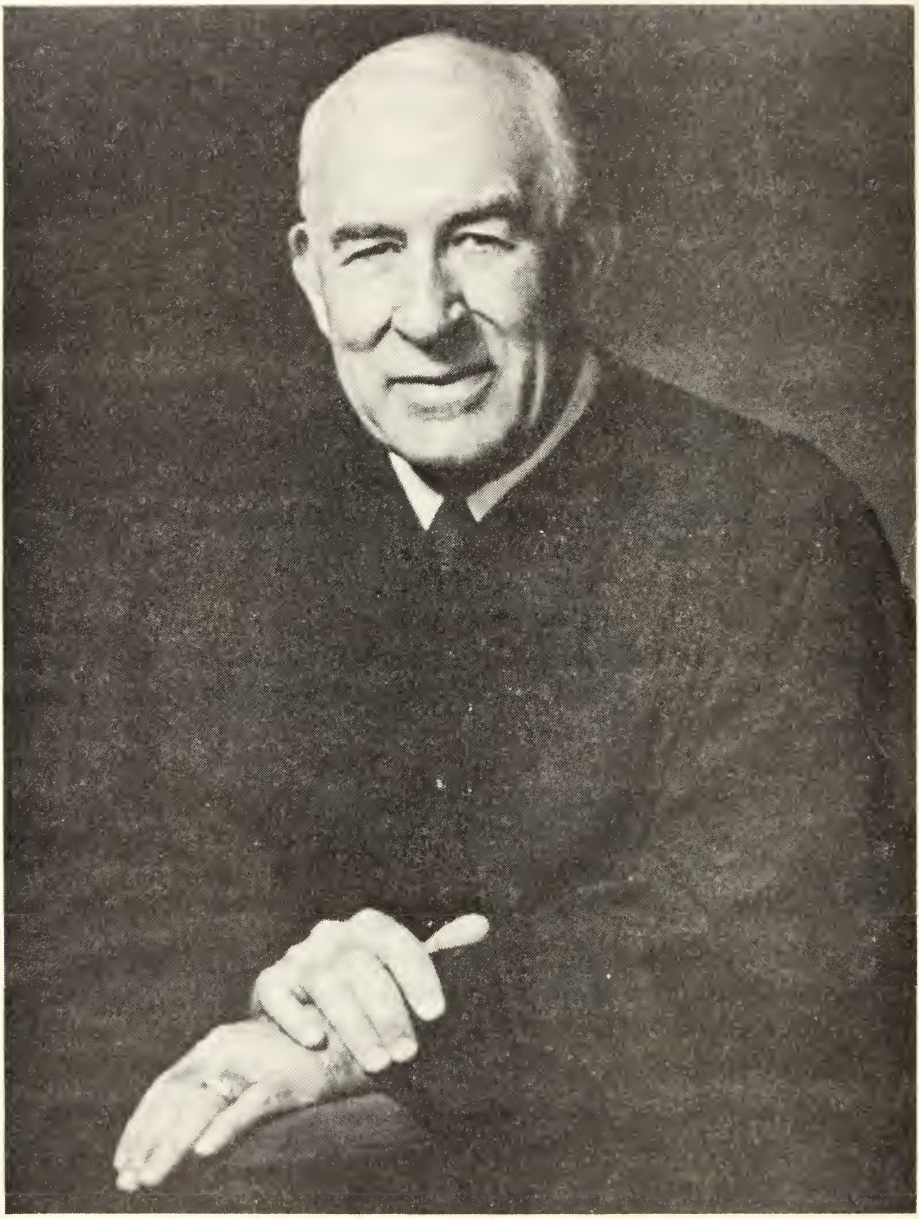

JUDGE ORMA R. SMITH
1904 - 1982

In Memoriam

Seldom do attributes of mind, character and personality coalesce in almost flawless proportions in a person to produce true greatness. Measured by human standards, Orma Rinehart Smith was, in my opinion, just such a person.

I did not know "Hack" Smith when he arrived at the Ole Miss campus in September 1921 and went out for freshman football, or when he later entered the University of Mississippi Law School, then housed at what is now the old Geology building, and studied under the watchful eye of Dean Kimbrough. Nor did I know Orma Smith when he graduated from law school on June 27, 1927, with these words inscribed beneath his picture in the yearbook:

> "Hack" is famous for many things but most of all for making his debut in the mock trial in his Junior year as "Poor Ole Hack Smith." He is the maker of friends and will some day be one of Mississippi's leading barristers.

I wish I could have known him in those years but I was then busily occupied in playing marbles at a Greenville grammar school and could not be expected to know our paths would cross, first as workers in the Mississippi State Bar, and then as colleagues on the federal trial bench in Northern Mississippi during an era of perhaps the most traumatic social upheaval our state had known since the Civil War. It is wonderful to contemplate that Orma Smith did consistently achieve signal success in all of life's relationships, and endeavors as devoted husband, father and grandfather, as one ever supportive of his church, community and the civic good, as a tireless and effective advocate and counselor in his chosen profession, as a farsighted and statesmanlike leader in the Mississippi State Bar, and ready and fully prepared to assume and discharge with distinction the demanding duties of United States District Judge.

It was in this latter aspect that I came to know our subject so well and to study him so closely, to admire him so greatly and

to love him so profoundly. Happily, the tributes to Judge Smith from the bench and bar of Northern Mississippi were made known to him on that bright day, July 11, 1980, at Aberdeen, and students of the law and of Judge Smith may always turn to Volume 507 of the *Federal Supplement* for expressions on the occasion of the official presentation of his portrait to our court by the Bar of the Northern District of Mississippi.

Judge Smith finished his labors on earth with unabated interest in his court and its functions and with tender concern for this Republic and its citizens. His indomitable courage in meeting every issue, his integrity and high principle unsullied by base motive, his unflagging energy in attending to the business at hand, and his unfailing courtesy and kindly manner in greeting his fellow man, are things for us to remember along life's journey.

Editor's note: These remarks were prepared by Hon. William C. Keady of Greenville, Chief Judge of the United States District Court for the Northern District of Mississippi.

THE UNIVERSITY OF MISSISSIPPI SCHOOL OF LAW MEMORIAL LECTURES

The Law Memorial Lectures were established at the University of Mississippi School of Law in 1973 by the law firm of Butler, Snow, O'Mara, Stevens & Cannada of Jackson, Mississippi. In establishing the Lectures, the firm honored the memory of its founding partners: George H. Butler, Sr., Charles B. Snow, and J. Morgan Stevens. The purpose of the Lectures, as defined in the granting document, is to "provide substantial educational enrichment opportunities for the students and faculty of the Law School, and such members of the bench, bar, and academic community as may appropriately be included." This worthy purpose has been implemented since 1974 by bringing to the Law School a notable array of distinguished legal scholars. Professor Philip B. Kurland of the University of Chicago Law School initiated the series with his memorable lectures on "Watergate, Impeachment and the Constitution." Phil Kurland was followed by Professor Charles Frankel of Columbia University, Dean Monrad Paulsen of the University of Virginia Law School, Dean John W. Wade of the Vanderbilt Law School, Professor Myres McDougal of the Yale Law School, Professor Robert B. McKay, former Dean of the New York University Law School and Director of the Aspen Institute for Humanistic Studies, and The Right Honourable Lord McCluskey, Q.C., the former Solicitor-General for Scotland. These distinguished lecturers, although disparate in areas of concentration, style, and nationality, were unified in common—or perhaps uncommon—talents of intellect, creativity, and forceful eloquence. Their encounters with the students and faculty of the Law School have been enormously valuable; we have been informed, intellectually challenged, and inspired by the dynamism of their presence. The Lectures have indeed fulfilled the goals envisioned by the founders in 1973.

The 1982 Lectures continue the rich tradition of bringing to the Law School the best minds in legal education. Abraham S.

Goldstein enjoys general recognition as one of the preeminent legal scholars currently teaching and writing in the United States. Holder of a coveted Sterling Professorship at the Yale Law School, Abraham Goldstein is a stellar member of perhaps the most intellectually stimulating law faculty in North America. Indeed, his professional life has been related to Yale for more than three decades. He entered the Law School in 1946, served as Articles Editor of the *Yale Law Journal,* and received the LL.B. degree in 1949. He was a law clerk for a United States Court of Appeals Judge and thereafter practiced law with the Washington, D.C., firm of Donohue & Kaufmann. Leaving the firm as a partner, Professor Goldstein began his distinguished law teaching career at Yale in 1956. He was appointed Dean of the Yale Law School in 1970 and provided vigorous, inspired leadership during his five-year term.

Professor Goldstein has been the recipient of several distinguished appointments abroad. In 1964-1965, he was a Visiting Fellow at the Institute of Criminology and a Fellow of Christ's College, Cambridge University. He was a member of the faculty of the Salzburg Seminar in American Studies in 1969 and was a visiting professor at Hebrew University in Jerusalem in 1976. He has twice received Guggenheim Fellowships, in 1964 and again in 1975.

A prolific writer, Professor Goldstein has contributed numerous articles and reviews to professional journals. He is the author or co-author of three books: *The Insanity Defense* (1967), *Crime, Law and Society* (1971), and *Criminal Procedure: Cases and Materials* (1974).

In addition to his academic pursuits, Professor Goldstein has undertaken an impressive number of civic tasks. He has served as a consultant to the President's Commission on Law Enforcement, as Chairman of the Commission on Law and Social Action of the American Jewish Congress, and as a member of the Governor's Commission to Revise the Criminal Statutes of Connecticut, the Connecticut Planning Commission on Criminal Administration, and the Board of Directors of the Connecticut Bar Foundation.

The 1982 Lectures are an important contribution to a troubled field. In defining the role of the crime victim, Professor

Goldstein deals creatively with a problem that lies at the root of the current national disillusionment with the criminal justice system. His suggestions are valuable and unquestionably useful in the awesome task of restoring credibility, respect, and effectiveness to the institutions that maintain order in our society.

Dean Parham H. Williams, Jr.
University of Mississippi School of Law

DEFINING THE ROLE OF THE VICTIM IN CRIMINAL PROSECUTION*

*Abraham S. Goldstein***

There is a remarkable consensus that our public institutions —police, prosecutor, courts, and prison—are doing badly in dealing with the crime problem. That consensus reflects a pervasive feeling that the criminal law, and the threat of sanction standing behind it, is not taken seriously. The sense of crisis is accentuated by the problem of declining resources. Less seems to be available to deal with more offenses and more offenders. The result is a growing feeling of impotence—a feeling that the authorities cannot relieve the problem and that there is little or nothing that the rest of us can do. This decline of faith in our institutions of public order has had a corrosive effect. Victims report fewer crimes to the authorities because they do not expect them to be responsive. Police and prosecutor accommodate to the lowered expectation that they will not arrest and prosecute for all or even most crimes. And as both reporting and enforcement decline, potential offenders make their calculations about the costs and benefits of criminal activity and they see the odds favoring crime.

Under such circumstances, the pressure on law-abiding people to help themselves has increased. People have turned from reliance on public agencies to methods of avoiding the places and situations that seem to invite crime. In workplace and school, instructions are given on where to walk, how to carry

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* Copyright 1982 by Abraham S. Goldstein. The Law Memorial Lectures delivered on March 22-24, 1982, at the University of Mississippi. The Lectures are reprinted here substantially as delivered, except for the addition of footnotes. The research for this article was supported in part by Grant No. 78-NI-AX-0017, awarded by the National Institute of Justice to the White Collar Crime Project at Yale Law School. The views expressed herein are solely those of the author. I am grateful for the research assistance of Richard Hill and Danzey Burnham, then students at Yale Law School.

** Sterling Professor of Law, Yale University. B.B.A., 1946, City College of New York; LL.B., 1949, Yale University.

purses and wallets, what hours to keep. The burglar alarm industry grows; private police forces expand their services; street lighting is improved; escort services and karate classes flourish. Victims have even begun to accept the inevitability of crime. Increasingly, they are made to feel responsible for having failed to avoid the criminal encounter.[1] Shopkeepers are told that open shelves tempt shoppers too much. Women are told not to carry purses and not to wear sweaters. Homeowners are told not to leave their houses dark too long—not merely as protective advice but as if it is the victim's conduct that "causes" the offender's crime.

The displacement of blame from offender to victim seems to assume some sort of equilibrium—a fixed quantum of crime that can be reduced either by "them" refraining from crime or by "us" avoiding it. It assumes that if we can not get "them" to stop by using the criminal justice system, perhaps we can deny them the opportunity to be delinquent by changing the way we look and live. In short, it rests on a common tendency to blame ourselves for what is done to us by others. And that tendency, in turn, often masks anger and resentment. It was to be expected that these repressed feelings would soon be expressed by victims and by the larger public that identifies with them.

I. The Impact of the Victims' Movement

In this article, I shall discuss the return of the victim to a prominent role in the criminal justice system. Victims and potential victims—often crossing ideological boundaries—are pressing for fuller enforcement of the criminal law, more rapid disposition of cases, and more effective sentences. Women, and

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[1] The field of victimology had its origins in H. von Hentig, The Criminal and His Victim (1948). It is rooted in an insight, drawn from abnormal psychology, that some victims "seduce" their offenders by perversely placing themselves in situations to be victimized. This notion sometimes has been extended too casually beyond its proper boundaries. There is now an annual volume reporting research on victimology, as originally understood, and on its broader contemporary ramifications that involve all aspects of the victim's relation to criminal justice. *See, e.g.*, 2 Victimology: A New Focus (I. Drapkin & E. Viano eds. 1973); *see also* Walsh & Schram, *The Victim of White Collar Crime: Accuser or Accused?*, in White Collar Crime: Theory and Research 32, 42-45 (G. Geis & E. Stotland eds. 1980).

feminists, press for prosecution of husbands who beat their wives and question the frequency with which rape charges are reduced to indecent assault. Blacks and Hispanics protest a double standard that treats the ghetto as a lawless enclave in which crimes committed by one resident against another are ignored while crimes committed by those who stray outside the ghetto are routinely prosecuted. Consumers complain of the failure to prosecute frauds and white collar crimes. The elderly, and all of us, call for stricter enforcement of laws dealing with street crimes. Many of these groups have even become court watchers, hoping that their presence in the courtroom will inhibit judges from imposing unduly light sentences and will restrain prosecutors from using their discretion too casually in dismissing or reducing charges and entering into plea bargains.

The new interest in victims may fairly be described as a victims' movement. The movement is broad-based and has gained genuine momentum at the local, state, and national levels. It is marked by a substantial body of literature that counts victims with increasing accuracy, describes with care the experience of victimization and what it entails in the way of outrage and personal and economic injury, and is developing its own body of theory. There is a National Organization for Victim Assistance (and local counterparts) that promotes a Victims' Bill of Rights. There is a Section on Victims' Rights within the American Bar Association and similar sections in state and local bar associations. Research programs and curricular changes and conferences are being built around the issue.[2]

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[2] *See, e.g.*, H. BROWNWELL, THE FORGOTTEN VICTIMS OF CRIME 22 (1976); L. LERMAN, PROSECUTION OF SPOUSE ABUSE: INNOVATIONS IN CRIMINAL JUSTICE RESPONSE 2 (1981); Ash, *On Witnesses: A Radical Critique of Criminal Court Procedures*, 48 NOTRE DAME LAW. 386, 386-424 (1972); Hindelong & Gottfredson, *The Victim's Decision Not to Invoke the Criminal Justice Process*, in CRIMINAL JUSTICE AND THE VICTIM 57, 75-77 (W. McDonald ed. 1976); McDonald, *Towards a Bicentennial Revolution in Criminal Justice: The Return of the Victim*, 13 AM. CRIM. L. REV. 649, 649-73 (1975); McGuir & Edelhertz, *Consumer Abuse of Older Americans: Victimization and Remedial Action in Two Metropolitan Areas*, in WHITE COLLAR CRIME: THEORY AND RESEARCH, 266, 266-90 (G. Geis & E. Stotland eds. 1980); Walsh & Schram, *supra* note 1, at 32. For illustrative statistics, see LAW ENFORCEMENT ASSISTANCE ADMIN., U.S. DEP'T OF JUSTICE, CRIMINAL VICTIMIZATION IN THE UNITED STATES, A COMPARISON OF 1974 AND 1975 FINDINGS 1-51 (1977); LAW ENFORCEMENT ASSISTANCE ADMIN., U.S. DEP'T OF JUSTICE, CRIMINAL VICTIMIZATION IN THE UNITED STATES 1973, 1-158 (1976); *LEAA Programs Aid Crime Victims,*

In the curious ways of history, victim resentment and victim pressures may serve not only a cathartic purpose for the victim but may have a restorative effect on the criminal justice system. By insisting that the victim's concerns be weighed alongside those of prosecutor and defendant, the victims' movement may force us to reconsider some fundamental questions about the objectives of criminal justice and how it should be administered.

A. The Alienation of the Victim

A key assumption underlying the victims' movement is that the failure of victims to cooperate with the criminal justice system has reached epidemic proportions. Recent statistical studies of victimization confirm what we have known for some time. Victims often do not report to the police the crimes that have been committed against them. And the more crime we have, the larger this "dark figure" of unreported crime becomes. Even when they report crimes, a remarkably large proportion of victims later refuse to testify, which leads prosecutors to dismiss or reduce charges. Conversely, victims often find police unwilling to investigate and prosecutors unwilling to charge. In short, each—"authorities" and victims—finds the other uncooperative, resulting in a reciprocal cycle of decline. Confidence in justice is eroded, enforcement efforts are impeded, and conviction rates, when measured against crimes actually committed, tumble downward.

This theme of alienation, which runs through the victims' movement, traces to a deeply held feeling that the victim has been so much separated from the crime against him that the crime is no longer "his." The sense of alienation probably began when the civil action for damages was split off from the criminal prosecution. A fine paid to the King became a substitute, at least in the criminal process, for compensation previously paid by the offender to the victim and his family. Alienation was accentuated when private prosecution—by victims or by any member of the public—was abandoned in the United States and the

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Witnesses, 2 JUST. ASSISTANCE NEWS, June-July 1981, at 11, 11 (week of April 19, 1982, declared Victim's Rights Week).

public prosecutor was given a monopoly of the criminal charge.[3]

The victim has been left to play a distinctly secondary role. He reports crimes to public officials and leaves it to them to decide whether offenders should be prosecuted and punished. His injury becomes the occasion for a public cause of action, but he has no "standing" to compel prosecution of the crime against him or to contest decisions to dismiss or reduce the charges or to accept plea bargains, or to challenge the sentence imposed on the offender who injured him, or to participate in hearings on restitution. He is, in a sense, represented by the district attorney, but if his interest in pressing the charge comes into conflict with the prosecutor's conception of the public interest, the latter will prevail. And what is seen to be in the public interest may consist of elements that have little or nothing to do with the victim's case—its strength or weakness—or the nature of the victim's injuries or his outrage against the defendant or even his fear that the crime may be repeated. It may turn on the utility of the defendant as a state witness in another case, or on correctional factors that make it seem preferable to abandon the victim's case rather than prosecute the offender on a serious charge or on any at all. It may turn on whether the particular offense has a high priority at the moment. Thefts and burglaries and consumer frauds may be low on the priority list, crimes of violence high. Spouse abuse may be a disfavored charge, assaults by one ghetto resident against another not worth bothering with. The decision may not be made on qualitative grounds at all. The victim's interest may be subordinated to the more amorphous administrative objective of making the most of the prosecutor's limited resources, or keeping the court's dockets from being clogged, or keeping the prisons from overflowing.[4]

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[3] *See generally* A. Goldstein, *Prosecution: History of the Public Prosecutor*, in ENCYCLOPEDIA OF CRIME AND JUSTICE (S. Kadish ed. 1983); Hall, *Interrelations of Criminal Law and Torts: I*, 43 COLUM. L. REV. 753, 753 (1943) [hereinafter cited as Hall I]; Hall, *Interrelations of Criminal Law and Torts: II*, 43 COLUM. L. REV. 967, 967-1001 (1943) [hereinafter cited as Hall II].

[4] *See generally* A. GOLDSTEIN, THE PASSIVE JUDICIARY: PROSECUTORIAL DISCRETION AND THE GUILTY PLEA 70-73 (1981); F. MILLER, PROSECUTION: THE DECISION TO CHARGE A SUSPECT WITH A CRIME 173-78 (1969); Hall, *The Role of the Victim in the Prosecution and Disposition of a Criminal Case*, 28 VAND. L. REV. 931, 932-85 (1975).

It is easy to understand both the prosecutor's difficulties and the victim's frustrations. To the prosecutor, the victim is one among many competing interests. To the victim, the prosecutor is a bureaucrat who holds decisive power over his use of the criminal law—whether to give him emotional satisfaction or to deter the offender or to obtain financial reparation for his injuries. And the bureaucrat is often busy with things other than the victim's case—much more so today when the number of crimes and criminals is much greater than when public prosecution first supplanted the victim's right to prosecute on his own.

In any event, a collective memory has developed by now that makes the victim feel uninvolved in the crime against him and that makes him regard the criminal law as unresponsive to his concerns. He is told that he is not a "party" but a "mere witness." His complaints are often not investigated. The prosecutor need not tell him whether a charge has been filed or why it has been reduced from the offense complained of to a lesser one. Neither prosecutor nor judge need advise him of the terms of plea arrangements or sentences. And little or nothing need be done in the criminal case to facilitate his obtaining financial compensation for his injuries.

Though the victim may begin with the assumption that it is the wrong against him that is to be requited by the criminal law —that the prosecutor is his surrogate, proceeding in his place and on his behalf—he is too often persuaded by the "system" that the criminal prosecution is not really "his" business at all. It is little wonder that so many victims do not bring their complaints to the police or, if they do, that they become unwilling witnesses who are responsible for the high rate of dismissals of prosecution.

B. Programs and Proposals

A variety of experimental programs and demonstration projects have emerged in recent years that build on the hypothesis that victim reporting and cooperation in law enforcement can be improved by alleviating the difficulties faced by the victim-as-witness and by offering some prospect of financial reparation for the injuries suffered by him as a result of the crime. These may be grouped into three categories: (1) restitution programs;

(2) victim compensation statutes; and (3) victim/witness programs.

1. Restitution Programs

The crime victim traditionally has had two ways of obtaining financial reparation: by filing a civil suit against the offender for damages or by obtaining an award of restitution in the criminal case itself. Because an award of restitution involves payments by the offender to the victim rather than to the state, it provides the victim with a financial incentive to cooperate in prosecution. And it makes clear to the offender that he has injured not a disembodied state but a real individual.

Restitution came into vogue in the United States and in England in the late nineteenth and early twentieth centuries as part of the increasing emphasis on rehabilitation, and soon became a standard feature of release on probation.[5] It was often suggested in that early period that "restitutive justice" should be the principal objective of criminal law, requiring the offender to repay the victim from his own resources or from wages to be earned by him later, in prison or out. More recently, that suggestion has been revived and elaborated in the writings of Schafer, Barnett and Hagel, and Hudson and Galaway.[6] The theory, in its current form, starts from the Kantian premise that restitution is the most effective means of restoring the condition of things as they were before the crime disturbed the relations between offender and victim and between the offender and society.[7] In addition, restitution is viewed as the the best way to get

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[5] Jacob, *Reparation or Restitution by the Criminal Offender to His Victim*, 61 J. CRIM. L. & CRIMINOLOGY 152, 166-67 (1970); Laster, *Criminal Restitution: A Survey of the Past History and an Analysis of Its Present Usefulness*, 5 U. RICH. L. REV. 71, 71-98 (1970); Note, *Restitution and the Criminal Law*, 39 COLUM. L. REV. 1185, 1187 (1939).

[6] *See* S. SCHAFER, COMPENSATION AND RESTITUTION TO VICTIMS OF CRIME 3 (2d ed. 1970); Barnett & Hagel, *Assessing the Criminal: Restitution, Retribution, and the Legal Process*, in ASSESSING THE CRIMINAL: RESTITUTION, RETRIBUTION, AND THE LEGAL PROCESS 1, 1-5 (R. Barnett & J. Hagel eds. 1977); Galaway, *Toward the Rational Development of Restitution*, in RESTITUTION IN CRIMINAL JUSTICE 77, 80-85 (J. Hudson & B. Galaway eds. 1975); Hudson & Galaway, *A Review of the Restitution and Community Service Sanctioning Research*, in VICTIMS, OFFENDERS, AND ALTERNATIVE SANCTIONS 173, 173-91 (J. Hudson & B. Galaway eds. 1980).

[7] 2 E. CAVID, THE CRITICAL PHILOSOPHY OF KANT 377-78 (1889).

the offender to realize the harm he has done and to accept genuinely his responsibility by repairing it, while also offering greater promise of rehabilitation than fines or imprisonment. For offenders who can safely be released, a restitutive theory offers an alternative to imprisonment by providing emotional and economic satisfaction to the victim, vicarious satisfaction to family and friends, and some degree of deterrence to offenders.

It has been difficult to sustain enthusiasm for restitution. It often proves to be an empty gesture because most offenders have no money and poor job prospects. Nevertheless, for defendants with means, it has continued to be an attractive albeit little-used sentencing measure. With the new prominence of the victim, however, restitution has again moved to center stage. Resitution programs have been established in state and federal courts, sometimes under the aegis of the courts and sometimes through agencies loosely affiliated with them. As these programs have gained in popularity, they have become more ambitious and more varied. Some are concerned with financial reparation to the victim alone. Others have sought to include restitution through community service, either where financial reparation is unlikely or where the nature of the crime makes it appropriate. Yet others have expressed confidence that offenders can be rehabilitated through a process of "creative restitution."[8] It comes as no surprise to learn that as these programs multiply, they sometimes conceal conflicting objectives. Old ideologies oriented towards the offender sometimes get in the way of the new ones that are primarily concerned with the victim. As Hofrichter points out:

> [The] intellectual and practical origins of restitution are . . .

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[8] In trying to use restitution "creatively" or "therapeutically," victims and offenders are often brought together. The device seems to work better for crimes committed against family and friends than for crimes against strangers. *See, e.g.*, Eglash, *Creative Restitution*, 48 J. CRIM. L., CRIMINOLOGY & POLICE SCI. 619, 620 (1958); Fogel, Galaway & Hudson, *Restitution in Criminal Justice*, 8 CRIM. L. BULL. 681, 681-91 (1972); Galaway, *Restitution as an Integrative Punishment*, in ASSESSING THE CRIMINAL: RESTITUTION, RETRIBUTION, AND THE LEGAL PROCESS 331, 341-43 (R. Barnett & J. Hagel eds. 1977).

Many restitution programs are restricted to non-violent property offenses and make no effort to obtain restitution for robbery and other violent offenses.

> found in the wing of American corrections [that emphasizes its] positive rehabilitative effects on the offender. Perhaps in consequence, the majority of restitution programs rarely concern themselves very much with making victims whole or attending to their needs, desires, or rights . . . . When [victims] manage to receive benefits, it is almost a lucky by-product of the process.[9]

2. Victim Compensation Statutes

When it became clear that restitution offered only limited possibilities of compensation for the victim, the emphasis shifted to a species of social insurance administered by a public agency that makes payments directly to the victim. These payments do not depend, as in restitution, on the offender being caught. Instead, they are based on the assumption that crime is so pervasive a condition and civil remedies against offenders so illusory that the burden of crime must be shared by the entire society. Victims' compensation programs have now been enacted by statute in about half the states and are included in the proposed revision of the federal criminal code.[10] Arguments for these programs are often accompanied by assertions that the state has too long squandered its resources on the offender and that it is time to demonstrate tangible concern for the victim.

Unfortunately, compensation programs have proved also to be a partial remedy. First, they are available only to victims of

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[9] Hofrichter, *Techniques of Victim Involvement in Restitution*, in VICTIMS, OFFENDERS AND ALTERNATIVE SANCTIONS 103 (J. Hudson & B. Galaway eds. 1980).

[10] *See* Edelhertz & Geis, *Public Compensation of Victims of Crime: A Survey of the New York Experience*, 9 CRIM. L. BULL. 5, 6 (1973); Harland, *Compensating the Victims of Crime*, 14 CRIM. L. BULL. 203, 204 (1978); Lamborn, *Remedies for the Victims of Crimes*, 43 S. CAL. L. REV. 22, 52-53 (1970) (describing inadequacy of existing civil and criminal remedies and recommending governmental compensation programs); Starrs, *A Modest Proposal to Insure Justice for Victims of Crime*, 50 MINN. L. REV. 285, 290-91 (1965); Comment, *Rehabilitation of the Victims of Crime: An Overview*, 21 U.C.L.A. L. REV. 317, 318-20 (1973). *But see* Blum, *Victims of Crime and Other Victims*, 52 CHI. B. REC. 463, 465-68 (1971) (arguing against singling out crime victims from other victims in providing governmental compensation for injuries).

For examples of state victims' compensation statutes, see CAL. GOV'T CODE §§ 13959-13966 (West Supp. 1982); HAWAII REV. STAT. §§ 351-1 to -70 (1976); N.Y. EXEC. LAW §§ 620-635 (McKinney Supp. 1981).

violent crime. They make no provision for damages suffered by victims of non-violent crimes, and the awards they do authorize are relatively low. Second, they make little effort to serve the objectives of criminal law. Though the statutes usually require that the victim report the crime to the police, they do not require that the offender be apprehended or convicted. This reduces rather than enhances the incentive to cooperate in the prosecution until it is completed. Additionally, the offender is not made responsible for payment to the victim, thereby reducing his sense of responsibility for the damage he has done. Like insurance schemes generally, they blur the person-to-person relationship and the sense of personal and financial accountability. Such programs may succeed, therefore, in pacifying the victim while making the enforcement of criminal law even less effective.

3. Victim/Witness Programs

Victim/witness programs are concerned with the "secondary victimization" suffered by victims when they become complaining witnesses. Too often, they are dealt with perfunctorily by police and prosecutor. They are asked to wait and to come back again and again as hearings are delayed to serve the interests of prosecution or defense or court. They are subjected not only to uncomfortable waiting rooms but also to lost wages for days away from work, the expense of baby sitters, and the risk of intimidation by the offender's family and friends.

It seemed plausible that victim cooperation—both in reporting crime and in testifying about it—would be improved if victims were treated better by the legal system. To test that hypothesis, a series of victim/witness programs have been instituted, either in conjunction with prosecutors' offices or, more generally, under the supervision of the courts. The best known of these programs was established by the Vera Institute of Justice in cooperation with the District Attorney's office in Brooklyn, New York.[11] The Vera program, and others that followed, have tried to minimize the difficulties confronted by victims as

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[11] VERA INSTITUTE OF JUSTICE, FELONY ARRESTS: THEIR PROSECUTION AND DISPOSITION IN NEW YORK CITY'S COURTS 135-40 (1977).

witnesses. Their efforts include reducing unnecessary trips to court by improving victim notification procedures; providing comfortable and secure waiting rooms, and even nursery facilities for children; as well as furnishing transportation to and from the courthouse and explaining to victims what is happening at each stage of the legal process. Victim/witness programs may even include referral to social service agencies, emergency aid to victims, and legal assistance when the crime leads to difficulties with landlords, creditors, and employers. But these programs do not ordinarily cross the line to what has come to be called victim advocacy, probably because they depend for their success on a "service" relationship to the prosecutor and the court.[12]

Victim/witness programs have learned that victims are as diverse as those who offend against them, perhaps even more so. Some victims are affluent, and some are not. Some are strangers to the offenders; some are intimately involved with them emotionally or economically, and in family or business relationships or both. In order to serve these diverse constituencies of victims, the programs have often had to move outside the original pattern of "helping" the witness to help the prosecutor, and to try instead to solve the victim's problems more directly. In many instances, they find that the criminal charge is a point of entry for people seeking solutions to a remarkable range of problems. Victims may come to the criminal process because they think a show of public force is necessary to get relief, not because they want to imprison the offender. In cases of minor theft, bad checks, fraud, or property damage, which comprise a remarkably large proportion of criminal business, the victim may want only monetary compensation or restitution. In cases of domestic violence and neighborhood disputes, the criminal complaint may be a call for help in deteriorating personal relationships. The prose-

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[12] *See supra* note 11, *infra* note 15. For descriptions of victim/witness programs, see WEIGEND, ASSISTING THE VICTIMS (Max Planck Institute for Foreign and International Criminal Law, 1981) (surveying programs in various parts of the United States); E. CANNAVALE & W. FALCON, WITNESS COOPERATION 31-36 (1976). The Victim Services Agency of New York City prepares periodic reports on its programs. *See* B. ALPER & L. NICHOLS, BEYOND THE COURTROOM: PROGRAMS IN COMMUNITY JUSTICE AND CONFLICT RESOLUTION 82-83 (1981).

cutor may become a conduit to a species of decriminalization, in which he treats the victim's interest as primary and has little inclination to press the claims of the criminal law. Many victim/witness programs have expanded to include mediation and arbitration services in an effort to pierce the criminal "label" and get to the genuine source of the dispute between victim and offender—a composite of emotional and financial conflicts not easily resolved in a criminal court. These services, in turn, have led to the emergence in some places of Community Dispute Resolution Centers and Neighborhood Justice Centers.

The victim/witness programs—in their narrow and in their broad forms—have met with widespread approval. They have been endorsed by bar groups and by the Attorney General of the United States,[13] and have been enacted into law in many states under a variety of models—some placing them in the prosecutor's office, some in the court system, and some in an independent agency.[14] Nevertheless, according to a study by New York's Victim Services Agency, which succeeded to Vera's Brooklyn program, the usual victim/witness programs are not by themselves sufficient to increase victim cooperation. While they provide comfort and information and assistance, which leave the victim with a more positive view of the legal system, and facilitate the disposition of cases that the prosecutor regards as essentially "private" and best left to mediation and "civil" remedies, they do not increase the attendance of victims at hearings and trials in serious criminal cases. As a result, they do not reduce significantly the dismissal rate for failure to prosecute in such cases. Similar conclusions have been reached in evaluations of comparable programs elsewhere.[15]

In serious cases, the victim's non-cooperation is not simply the result of being "worn down" by the demands or the insensi-

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[13] ATTORNEY GEN.'S TASK FORCE ON VIOLENT CRIME, U.S. DEP'T OF JUSTICE, FINAL REPORT 87-89 (1981).

[14] *See generally Victim/Witness Legislation: Considerations for Policymakers*, 1981 A.B.A. SEC. CRIM. JUST. *passim* (prepared by Victim-Witness Assistance Project of Section of Criminal Justice).

[15] The Brooklyn experience is described in R. DAVIS, V. RUSSELL & S. KUNREUTHER, THE ROLE OF THE COMPLAINING WITNESS IN AN URBAN CRIMINAL COURT, *passim* (Vera Inst. of Justice (1980)).

tivity of the criminal justice system. It is rooted instead in conflicts between the victim's and the prosecutor's objectives in prosecuting the case. The victim incurs financial and emotional costs when he "cooperates" and expects, as one result, that officials will attend to his concerns. But his views are rarely even solicited, much less attended to. Routines have developed in the courthouse that make prosecutors and judges inattentive to the victim's preferences about the critical decisions to be made in the case, including decisions on the charges to be brought, their reduction or dismissal, plea bargains and sentences, and restitution.[16] Victim-assistance programs, thus, tend to perpetuate a basic pattern of official neglect even while providing a high level of other services. The implication of these studies is that more victim involvement in critical decisions is necessary if his cooperation with the prosecution is to be increased.

There have been a small number of efforts to "involve" the victim more substantially. In these programs, courts and prosecutors have invited victims to present their views on the merits of plea negotiations and sentences, either at court hearing or by informal communication to the prosecutor or probation officer for transmission to the court. In some jurisdictions, for example, a victim-impact statement has become a routine item in the presentence report prepared by the probation officer.[17] In other jurisdictions, a victim advocate has been appointed to gather and present the victim's views to the prosecutor.

The best known of the victim-involvement programs was established in Dade County, Florida, as part of an experiment to test the effects of victim participation in "pretrial settlement hearings" looking towards guilty pleas.[18] A random selection was made of 1074 cases, of which 378 were assigned to a test group in which judge, victim, and defendant were to participate. The re-

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[16] *Id; see* McDonald, *Notes on the Victim's Role in the Prosecutorial and Dispositional Stages of the American Criminal Justice Process* table I, in SECOND INTERNATIONAL SYMPOSIUM ON VICTIMOLOGY (1976); Ziegenhagen, *Toward a Theory of Victim-Criminal Justice System Interactions*, in CRIMINAL JUSTICE AND THE VICTIM 261, 266-67 (W. McDonald ed. 1976).

[17] *See, e.g.*, Hofrichter, *supra* note 9, at 103-20.

[18] The experiment is described in LAW ENFORCEMENT ASSISTANCE ADMIN., U.S. DEP'T OF JUSTICE, PRETRIAL SETTLEMENT CONFERENCE: AN EVALUATION 1-7 (1979).

mainder were assigned to control groups. The victim was notified of each hearing and was invited to present his views. Court hearings were observed, participants were interviewed, and the results were analyzed. Those who participated in the hearings were more pleased with the process and the results than were a comparable group who did not participate. Moreover, the victims proved to be less disruptive and less retributively inclined than prosecutors, judges, and defense counsel feared they might be. Even more surprisingly, victim participation seems to have added to the efficiency of the proceedings. There was an overall *reduction* in the length of time it took to process the case from formal charge to closing, and a greater proportion of the test cases were closed on or before the scheduled trial date—apparently because the victim's presence facilitated communication among interested parties and crystallized veiws earlier as a result.[19]

A different form of victim-involvement was the establishment of a victim advocate to represent victims of crime in the area in which the University of Chicago is located.[20] This victim advocate combined elements of witness assistance with advocacy of the victim's interest to police, prosecutor, and court—albeit informally because the victim was not treated as a party who had a *right* to appear and present his views. The victim advocate proved to be less concerned with the victim than with the entire class of victims, more particularly with the University's interest in reducing crime in the area. He was more ideological than the individual victims, often taking a position towards them that was almost adversarial. In his discussions with the prosecutor, for example, he would consistently demand higher bonds and harsher penalties. If victims wanted to drop charges, he would try to dissuade them from doing so.

Both the Chicago and the Dade County experiments con-

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[19] *Id.* at 131; *see also* Knudten, Meade, Knudten & Doerner, *The Victim in the Administration of Criminal Justice: Problems and Perceptions,* in CRIMINAL JUSTICE AND THE VICTIM 115, 118-21 (W. McDonald ed. 1976).

[20] Dubow & Becker, *Patterns of Victim Advocacy,* in CRIMINAL JUSTICE AND THE VICTIM 147-60 (W. McDonald ed. 1976); *see* T. Becker, Victims and Their Lawyer: A Study of Victim Advocacy *passim* (June 1981) (unpublished dissertation, Northwestern University).

firmed the earlier research on victim/witness programs: a clear stake and role for the victim will increase the probability that he will cooperate in criminal prosecution. As a result, the suggestion is beginning to appear—in state legislatures and in the legal literature—that the victim should be given the right to be heard ("allocution") and perhaps even be made a party at specified stages of the criminal process.

The victims' movement, and the variety of programs and pressures emanating from it, have raised fundamental issues about the purposes of criminal law and the sanctions and remedies most likely to achieve those purposes. But those issues have been so caught up in the first flush of experimentation that they have not been subjected to careful analysis by the legal profession. Yet they have important implications for doctrines and institutions that are taken for granted, including the distinction between civil and criminal cases and the prohibition of private prosecution. By focusing on the victim, we are led to consider anew the scope of restitution in criminal law, whether the victim's interests are adequately represented by the prosecutor in the several stages of the criminal process, and whether criminal law need continue unenforced, because prosecutors are too busy, where victims stand ready to prosecute on their own.

II. The Revival of Restitution

I shall begin with restitution because the interest of the victim is so plain and because what may be done for him is so tangible. I shall consider the original enthusiasm for it as an aid to rehabilitation and the effect of a new group of statutes that free restitution from its relation to the offender's probation and anchor it in reparation to the victim. These statutes have set in motion a series of developments that may expand the role of the victim dramatically. My discussion shall take us in some detail into the scope of the wrong—the offense of conviction, the offenses charged, or the offenses committed even if not charged—for which restitution may be awarded. I shall then examine some procedural problems that arise when financial compensation to the victim becomes a part of the criminal case.

The concept of restitution traces to a time when there was no distinction between criminal sanctions and civil remedies.

Wrongs were requited by a single restitutive punishment sought by the victim and paid to him by the offender. When the state took control of the criminal sanction, it took the fine as well; thereafter, the only money paid by the offender in the criminal process was the fine paid as a punishment—not to the victim or his family but to the state for the offense against its law and authority. Forfeitures of property continued to occur after a criminal conviction, but they were regarded as vestigial exceptions to be strictly limited.[21] As a general proposition, the victim's rights to financial compensation were separated from the criminal law. He could obtain such compensation only if he brought a civil suit in tort.[22] Over the years, this public interest in criminal prosecution was further enforced, and private control reduced, by statutes that made it a crime for a victim to "compromise" his "public" action by settling it privately. He was prohibited from accepting money from the offender in return for abandoning his complaint in the criminal courts.[23]

This division of labor between the civil and criminal "remedy"—one compensatory and private and the other punitive and public—has been taken for granted and has occasioned relatively little comment. Yet, in both instances, the state provides a forum and a remedy through the courts for essentially similar reasons. Civil and criminal liability are each based on overlapping concepts of fault and recklessness and strict liability. "Wrongs" are to be made right by restoring the status quo ante—in tort by making the wrongdoer pay damages to the victim, in crime by offering emotional satisfaction to the victim and his family and those who identify with them. The interest in social order is served by both because the availability of legal rem-

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[21] The same is true of abatements of criminal nuisances and a miscellany of "civil" remedies retained here and there in particular provisions of the criminal code. *See* S. RUBIN, THE LAW OF CRIMINAL CORRECTION 296 (2d ed. 1973); Current Legislation, *"Red Light" Injunction and Abatement Acts*, 20 COLUM. L. REV. 605, 605-08 (1920).

[22] S. SCHAFER, *supra* note 6, at 3-6; *see* Edelhertz, *Legal and Operational Issues in the Implementation of Restitution Within the Criminal Justice System*, in RESTITUTION IN CRIMINAL JUSTICE 63, 72 (J. Hudson & B. Galaway eds. 1975).

[23] The origins and development of "compounding" as a crime is discussed in AMERICAN LAW INSTITUTE, MODEL PENAL CODE § 242.5 (Proposed Official Draft 1964).

Such compromises are now authorized under defined conditions in many states. *See* Hall, *supra* note 4, at 972; Annot., 42 A.L.R.3D 315 (1972).

edies, whether in crime or in tort, make private aggression and self-help less likely. The same is true of the interest in deterrence. Potential offenders are likely to be deterred from wrongdoing by the existence of any legal remedies against them, whether civil or criminal. Even prison and punishment are not unique to the concept of crime. Imprisonment is used to punish contempt in the civil courts and punitive damages may be awarded there.

We now take for granted that civil processes may be used to impose penalties, award double and treble damages, and enjoin dangerous conduct subject to punishment for contempt; that forfeitures may be ordered in criminal proceedings; and that fine and imprisonment are sanctions to be used alongside others to achieve the state's regulatory objectives. The point is not that civil and criminal measures have identical effects—all other things being equal, the criminal sanction is plainly more stigmatizing—but rather that calling something a "civil" remedy does not settle the question whether it may serve the purposes of the criminal law.[24]

Restitution is yet another illustration that our law does not distinguish as sharply between civil and criminal remedies as we have supposed. Police and prosecutor have routinely used it as a basis for reducing charges or recommending sentences or not charging at all. Judges have often conditioned release on probation on the offender's making financial reparation. This has occurred not only for crimes like theft, robbery, burglary, and embezzlement—where the "stolen" property is still susceptible of return, but also where the offender no longer has the property or where injuries are involved. During the period when the rehabilitative ideal was in vogue, restitution may well have been the most favored instrument for avoiding incarceration of the offender and for trying to rehabilitate him.[25]

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[24] *See* Hall I, *supra* note 3, at 758-60.

[25] Harland, *supra* note 10, at 215-16; *see supra* note 5; *see also* R. DAWSON, SENTENCING: THE DECISION AS TO TYPE, LENGTH, AND CONDITIONS OF SENTENCE 97, 105-09 (1969); R. NIMMER, DIVERSION: THE SEARCH FOR ALTERNATIVE FORMS OF PROSECUTION 27-30, 100 (1974); Brakel, *Diversion from the Criminal Process: Informal, Discretion, Motivation, and Formalization*, 48 DEN. L.J. 211, 218-19, 229-31 (1971).

"Restitution is most often used synonymously with the term reparation to signify

Eventually, however, restitution came to be treated in dismissive fashion even by those who favored compensation for crime victims. One commentator after another called attention to the fact that the remedy was an illusory one because most crimes are committed by poor people, and that permitting those who could make restitution to "buy" their way out of imprisonment was a form of discrimination against less affluent offenders.[26] Moreover, the emphasis on restitution was said to interfere with efforts to enact victims' compensation statutes that promised more relief to more victims. In discrediting restitution, the critics ignored the fact that it might occupy a distinctive place in the gallery of victims' remedies. The compensation statutes are applicable, after all, only to crimes of violence, which leaves compensation for property and economic offenses to the restitution remedy or to civil actions.

A. The Special Case of White Collar Crime

Restitution is especially appropriate and surprisingly underutilized for white collar offenses and offenders. These are the crimes committed in an organizational setting, generally involving fraud or abuse of trust by persons or corporations of means. Consumers, for example, may be victimized by a near infinity of

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the return of or compensation for stolen or damaged property and/or payment of monetary damages for injury to the person." Harland, *Restitution Statutes and Cases: Some Substantive and Procedural Constraints*, in VICTIMS, OFFENDERS AND ALTERNATIVE SANCTIONS 151 (J. Hudson & B. Galaway eds. 1980) [hereinafter cited as Harland, *Restitution Statutes and Cases*]. It usually includes the full range of financial reparation for the damage done, though it is unclear in many jurisdictions whether damages for pain and suffering will be permitted. *Id.*

[26] Alan Harland has questioned the assumption that most offenders cannot make restitution. He points out that the overwhelming proportion of offenses are thefts, which involve small amounts of money and are treated as unworthy of bother. He suggests that the problem may be as much one of administration as economics. Harland, *supra* note 10, at 220-21. On the discriminatory aspect of community service as an alternative to prison for white collar offenders, see Fried, *U.S. Judge Assails Sentencing of Felon to Community Jobs*, N.Y. Times, Feb. 21, 1982, at A38, col. 1. Even for offenders who cannot safely be released and who do not have financial means, restitution has a potential—but only if we are willing to pay genuine wages in prison. That would require the creation of economically viable prison industries, something that has met strong resistance over the years from industry and labor and from the public generally because scarce resources would have to be used for job training and welfare for the criminal population.

"business crimes"—among them, violations of the antitrust, food and drug, truth-in-lending, deceptive advertising, and environmental laws. Stockholders may be victimized by actions that result in declining stock values, often involving embezzlement and securities fraud by insiders trading to their advantage. Taxpayers may be victimized by false claims against the government, false statements to induce contracts, and frauds with regard to loans and housing. In these white collar cases, restitution is not an empty gesture at all, for several reasons. *First,* these offenders—individual or corporate—are affluent and their victims are likely to be of modest means, confounding the usual stereotypes about victims and offenders. White collar offenders have usually benefited financially from their crimes and have the means to make reparation to their victims. *Second,* these crimes are usually committed by persons who calculate rationally to gain economic advantage and are more susceptible to stigma and to sanctions that impose economic costs. For corporate offenders who cannot be imprisoned, only financial sanctions are realistically available; and fines of the usual sort are not sufficiently proportioned either to the gravity of the offense or to the financial gains achieved by the offender. For individual offenders, too, the usual criminal sanctions have been relatively ineffective as deterrents. Fines are usually too low. Imprisonment—because it is a sanction of last resort—is unlikely to be imposed, or imposed with sufficient severity, on enough offenders to serve as a deterrent. *Third,* the prospect of financial compensation provides an obvious incentive to victims to bring the crimes committed against them to the attention of the authorities and to participate in their prosecution. In this part of the criminal law, it may be wise social policy to harness the victim's interest in compensation to the deterrent objectives of the criminal law.[27]

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[27] *See generally* Katz, *The Social Movement Against White-Collar Crime,* in 2 CRIMINOLOGY REVIEW YEARBOOK 161 *passim* (E. Bittner & S. Messinger eds. 1980); LAW ENFORCEMENT ASSISTANCE ADMIN., U.S. DEP'T OF JUSTICE, THE NATURE, IMPACT AND PROSECUTION OF WHITE-COLLAR CRIME 3-72 (1970) (written by Herbert Edelhertz); Moore, *Notes Toward a National Strategy to Deal With White-Collar Crime,* in A NATIONAL STRATEGY FOR CONTAINING WHITE-COLLAR CRIME 21, 21-46 (H. Edelhertz & C. Rogovin eds. 1980); NATIONAL INST. OF JUSTICE, U.S. DEP'T OF JUSTICE, THINKING ABOUT WHITE COLLAR CRIME: MATTERS OF CONCEPTUALIZATION AND RESEARCH 1-60 (1980) (writ-

I should like at this point to clarify some words and phrases that are especially relevant to white collar crime, particularly the distinction between true victims and proxy victims. Restitution refers to payments by the offender for injuries or damage to identifiable victims of his crime. These may be true victims, who suffer directly from the crime, or proxy victims—a government agency or public interest group that stands in for true victims who do not realize they have been injured, or whose individual injuries are small, or who lack the motivation to voice their complaint. These proxy victims may serve as complaining witnesses because they have gathered information about the defendant's criminal activities and the injuries suffered by individual victims. They may also serve as vehicles for distributing restitutionary awards.

The role of the proxy victim is especially critical in dealing with white collar crimes—with consumer frauds or bribery or air pollution—because the issues involved may be too complex and costly to be pursued by individuals. The Securities and Exchange Commission, for example, is a proxy victim for stockholders injured by violations of the securities laws. The Post Office and the Federal Bureau of Investigation share responsibility for persons defrauded through the mails. The Federal Trade Commission and the Food and Drug Administration act for consumers. Local housing authorities enforce building codes for tenants. The ranks of proxy victims are supplemented also by private protectors of certain classes of victims, for example, unions, trade associations, public interest law firms, and more specialized organizations.

A true victim can describe the nature of his injuries, the extent of his outrage, and the degree to which he wishes to play a

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ten by Susan Shapiro); Ogren, *The Ineffectiveness of the Criminal Sanction in Fraud and Corruption Cases: Losing the Battle Against White Collar Crime*, 11 AM. CRIM. L. REV. 959, 970-81 (1973); Vaughn, *Crime Between Organizations: Implications for Victimology*, in WHITE COLLAR CRIME: THEORY AND RESEARCH 77, 93-95 (G. Geis & S. Stotland eds. 1980); Wheeler, *Trends and Problems in the Sociological Study of Crime*, 23 SOC. PROBS. 525, 525-33 (1976). The use of probation for corporate offenders as a way of obtaining not only restitution but also other corrective measures is discussed in Note, *Structural Crime and Institutional Rehabilitation: A New Approach to Corporate Sentencing*, 89 YALE L.J. 353, 371-72 (1979).

part in criminal prosecution or sentencing. A proxy victim, on the other hand, acts in a representative capacity, often through an official bureaucracy. Not only may the proxy victim be unable to assure that the true victims will cooperate in the prosecution, it may pursue the interests of some victims more energetically than others—trading the interests of some for the benefit of others or for its own sense of desirable long-range policy, as with the victim advocate who may have served the interest of the University of Chicago more than the interests of individual victims. A proxy victim may add a layer to the problems the true victim already faces when he deals directly with police or prosecutor, or both, thereby pitting the victim's interest against yet another agency's conception of the public interest.

It is important to keep in mind that not all offenses have true victims or even proxy victims to whom restitution can be paid. In the case of "crimes without victims," such as narcotics and gambling offenses, no one is regarded as the injured party. The defendant's violation of law is a threat to social solidarity (and "law-abidingness"), but the injury to any individual is an inextricable part of everyone else's injury and cannot be measured separately. In such cases, the public is the victim. I do not mean to suggest that it would be inappropriate to use financial measures other than fines against such offenders. In the case of a narcotics offender, for example, the profits from his illegal enterprise would seem quite properly to be payable to the state; otherwise the offender would be unjustly enriched. The same is true in the case of bribery of a public official. Even if it is difficult to determine how the bribe affects any one of us, the bribe amount should be recoverable, as well as the profits from the transaction. There are an increasing number of precedents for such financial sanctions, chief among them the federal RICO statute, which authorizes the United States Attorney General to trace illegal profits and recover them for the public.[28]

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[28] Racketeer Influence and Corrupt Organizations Act, 18 U.S.C. §§ 1961-1968 (1976). *See generally* Note, *Organized Crime and the Infiltration of Legitimate Business: Civil Remedies for "Criminal Activity,"* 124 U. PA. L. REV. 192, 192-222 (1975). On civil remedies in bribery, see Note, *Garnishing Graft: A Strategy for Recovering the Proceeds of Bribery*, YALE L.J. (a forthcoming issue).

B. The Appropriate Basis for Restitution

The amount of restitution turns on how one defines the injury or damage for which payment is to be made. Is it the damage done by the offense for which the offender was convicted? Is it that done by the offense or offenses charged in the indictment or information? Or is it the injurious results of the offense originally complained of by the victim and that could have been charged? The answers to these questions turn on the underlying theory of restitution and the importance of the distinction between civil and criminal cases and remedies. If restitution resembles an equitable remedy, the remedy should be as broad as the wrong. If, on the other hand, it is a punishment for crime, it should presumably be measured by the offense of conviction. Or is it meant to be a hybrid, combining elements of two different remedial objectives?

The courts have faced these questions in a series of cases involving the scope of the restitution required of an offender released on probation. Predictably, the answers have varied. Some make the offense of conviction the sole basis for restitution; others take a more flexible approach. In coming to their conclusions, the courts have looked for guidance to the language of relevant statutes and to the purposes of probation and restitution.

The current federal statute is typical of the laws in a substantial number of states that authorize restitution only for the offense of conviction. The limitation appears in the probation statute itself. The offender may be required to make restitution to an "aggrieved" person for "actual damages or loss caused by the offense for which conviction was had."[29] The language seems to leave no room for interpretation. Damage or loss is to be assessed only for the offense of conviction. If a single offense involving a single victim leads to a conviction, restitution would seem to be limited to that offense and that victim. If there are multiple victims of that offense, restitution may extend to all such victims. If the conviction is for a lesser offense than the one originally charged, restitution is limited to the lesser offense.

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[29] 18 U.S.C. § 3651 (1976 & Supp. IV 1980); *see* United States v. Roberts, 619 F.2d 1, 2 (7th Cir. 1979); Karrell v. United States, 181 F.2d 981, 987 (9th Cir.), *cert. denied*, 340 U.S. 892 (1950).

Yet there are difficulties in using the offense of conviction as the exclusive basis for restitution. The offense is often fixed at the end of a process that began with a much broader transaction between victim and offender—one that may have continued over a long period of time and may have included not only other crimes but also other victims. This is especially true of white collar crimes. The prosecutor's decision as to the number and nature of charges to include in the indictment or information may be based on any one of a variety of reasons, none of them bearing any relation to the restitutionary interests of the victim. As a result, the compensation awarded to the victim in the criminal case may be limited almost fortuitously by the offense that emerges from the vagaries of prosecutorial discretion and the plea bargaining process.

This lack of fit between the offender's "real offense" and the offense of conviction has led several federal courts to chafe at the restriction imposed by the statute and to search for a way to construe the restitution remedy more broadly. In *United States v. Buechler,*[30] the Third Circuit Court of Appeals provided a framework for a broad construction. After the defendant was convicted of embezzling $262, the trial judge ordered restitution in the amount of $3000 for a theft that the prosecutor had agreed not to prosecute. On appeal, the order was set aside to the extent it exceeded the $262 involved in the offense of conviction. The court specifically left open, however, the question whether broader restitution might be permissible "where the defendant explicitly agrees to it as one of the terms of a plea bargain in a multiple count indictment."[31]

The invitation implicit in that question was taken up in subsequent cases. It is now common for federal courts to make restitution a condition of probation for offenses that have been charged and then dismissed as part of a plea agreement that provides for such restitution. Though such a practice seems to ignore the statutory limitations, it has been justified on several grounds: (1) The defendant's admission of the offense and the loss set out in the indictment is a functional equivalent of con-

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[30] 557 F.2d 1002 (3d Cir. 1977).

[31] *Id.* at 1008 n.10.

viction; (2) It facilitates plea bargaining because restitution is often promised by the defendant in order to win charge reductions or dismissals or favorable sentences; (3) It enables the court to serve the rehabilitative purpose of probation by making the defendant accept responsibility for the full range of his criminal activity; (4) It would be unjust not to make the victim economically whole where it is feasible to do so.[32] In short, restitution to the victim and rehabilitation of the offender are treated as fundamental sentencing objectives that overcome the limits set forth in the probation statute. If these fundamental objectives can be fairly served, as by a genuinely consensual plea agreement, the offense of conviction is a minimal condition for restitution and not a maximum limit upon it.

At the other extreme from the federal statute is the Michigan law that authorizes the court to impose such conditions on probation "as the circumstances . . . warrant, or as in its judgment may be meet and proper."[33] Yet the Michigan cases have presented the same conflict about using unconvicted offenses as the basis for restitution. In *People v. Becker,*[34] the Michigan Supreme Court construed its statute as if it included the federal restriction.[35] In *Becker,* the defendant was convicted of leaving the scene of the accident and was placed on probation, conditioned on his paying the medical bills of two pedestrians he had struck with his automobile.[36] On appeal, the condition was held to be unlawful; because the defendant had been convicted merely of leaving the scene, he could not be made to pay for striking the pedestrians. The court spoke in language reminiscent of the federal statute:

> [T]he criminal has been convicted of one charge, but his freedom from incarceration (i.e., his condition of probation) is related to another act, precedent in time, with respect to which neither criminal charges nor civil complaint has been made . . . . [Restitution] can be imposed only as to the loss caused

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[32] United States v. McLaughlin, 512 F. Supp. 907, 909-10 (D. Md. 1981).

[33] MICH. COMP. LAWS ANN. § 771.3(4) (1968 & Supp. 1981).

[34] 349 Mich. 476, 84 N.W.2d 833 (1957).

[35] 84 N.W.2d at 835 (quoting MICH. COMP. LAWS ANN. § 771.3(4) (1981)).

[36] 84 N.W.2d at 834.

> by the very offense for which the defendant was tried and convicted.[37]

Recent Michigan cases, however, have abandoned the narrow construction and permitted "restitution of the whole loss caused by a course of criminal conduct upon conviction of a crime arising out of that conduct."[38] These cases make only occasional mention of rehabilitation; their orientation is plainly restitutionary.

The California courts have manifested even less inclination than Michigan's to limit restitution to convicted offenses. They have described the relevant statute as granting the trial judge a broad discretion to achieve a rehabilitative purpose.[39] They have awarded restitution for criminal conduct that has not been proved, or even alleged, in the criminal case to which the restitution order was appended.[40] A California court has even held that

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[37] *Id.* at 835-36, 838.

[38] *See, e.g.*, People v. Gallagher, 55 Mich. App. 613, 223 N.W.2d 92, 95 (1974) (defendant convicted of receiving cowl, valued at $1500, from stolen car, valued at $6277, required to make restitution for value of entire car); People v. Nawrocki, 8 Mich. App. 225, 154 N.W.2d 45, 46 (1967) (defendant convicted of uttering one forged check required to make restitution to victims of other forged checks).

These cases focus primarily on restitution with only an occasional mention of rehabilitation.

[39] The California Supreme Court has given the following construction to the relevant statute:

> [The statute authorizes a court to impose reparation conditions] and other reasonable conditions, as it may determine are fitting and proper to the end that justice may be done, that amends may be made to society for the breach of the law, for any injury done to any person resulting from such breach and generally and specifically for the reformation and rehabilitation of the probationer.

People v. Richards, 17 Cal. 3d 614, 619 n.3, 552 P.2d 97, 100 n.3, 131 Cal. Rptr. 537, 540 n.3 (1976) (construing CAL. PENAL CODE § 1203.1 (West 1970 & Supp. 1981)); *see* State v. Scherr, 9 Wis. 2d 418, 425, 101 N.W.2d 77, 81 (1960) (under a statute that refers to restitution as a condition of probation but sets no limits, "The issue . . . is the condition [to be placed on] probation in the public interest, not the civil liability of the defendant"—approving restitution beyond the amount charged in the information "where such amount is freely admitted by the defendant").

[40] *See, e.g.*, People v. Flores, 197 Cal. App. 2d 611, 17 Cal. Rptr. 382, 385 (1961) (defendant convicted of welfare fraud required to make restitution for payments received by him over longer period than that covered by the charge against him); People v. Reese, 136 Cal. App. 657, 29 P.2d 450, 451 (1934) (defendant convicted of frauds against specific victims required to reimburse all who had invested in fraudulent scheme, including those not named in the charge).

restitution could be required for non-criminal acts. In *People v. Miller*,[41] the defendant, a building contractor, had been convicted of unlawfully taking $821 from a couple whose home he had contracted to remodel. Restitution was ordered for "the victims in this case,"[42] leaving it to the probation officer to work out the details. Several months later, the officer filed a memorandum stating that there were claims of $8900, including claims by persons other than the couple who were victims of the convicted offense. Without any hearing, the court told the officer to direct the defendant to make payments pro rata among the victims. The appellate court affirmed the trial judge. Emphasizing the importance of rehabilitation, the court said the grant of probation "must be conditioned on the realities of the situation, without all of the technical limitations determining the scope of the offense of which defendant was convicted."[43]

In most states, there is an intermediate category of statutes that limit restitution to damages caused by "the offense," by "criminal acts," or by "criminal conduct." But they do not specify whether convicted or unconvicted offenses may be used. Judicial constructions of these statutes divide into two sub-groups, one virtually reading the "offense" limitation out of the statute and the other treating it as genuinely restrictive. In the first subgroup, restitution is construed liberally as a remedy that may be used to serve a variety of interests: the offender's in rehabilitation, the victim's in repayment, and the administrative needs of a legal system interested in plea bargaining. Little attention is devoted to procedural issues, though the courts invariably point

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[41] 256 Cal. App. 348, 64 Cal. Rptr. 20 (1967).

[42] 64 Cal. Rptr. at 22.

[43] *Id.* at 25. *See generally* Note, *Use of Restitution in the Criminal Process: People v. Miller*, 16 U.C.L.A. L. REV. 456, 459-73 (1969).

The California courts have, however, set some limits to restitution. *See, e.g.*, People v. Richards, 17 Cal. 3d 614, 623, 552 P. 2d 97, 103, 131 Cal. Rptr. 537, 543 (1976) (in reversing award of restitution for crime of which defendant had been acquitted, court concluded that requiring such restitution would in no way rehabilitate defendant for his proven criminal conduct, noting, in addition, that "the court held no hearing to determine facts other than those which led to defendant's acquittal"); People v. O'Rourke, 105 Cal. App. 3d Supp. 1, 4, 165 Cal. Rptr. 92, 93 (App. Dep't Super. Ct. 1980) (rejecting restitution for unconvicted offense involving a state of mind different from that in convicted case).

out that the unconvicted offenses are based on uncoerced admissions by the defendant—either to the police, the prosecutor, or the probation officer.[44]

The second sub-group of cases virtually converts "offense" into "offense of conviction." In *State v. Redecker*,[45] the trial judge imposed a condition on a convicted thief that he make restitution for $15,170, in addition to $533 for the value of the property stolen.[46] The appellate court reversed, saying "[The additional amount is] a stranger to *this case* . . . . [It] represents some other alleged or *assumed* peculation or aggregate of offenses without specificity in the record here."[47] The court described the restitution condition as essentially coerced—"akin to an alternative to pay up something not found in the record or be imprisoned for debt."[48] Similarly, in *State v. Reese*,[49] the court reversed an order requiring a defendant to pay $2000 to the victims of dismissed and uncharged offenses. The evidence supporting the dismissed charges had been suppressed as the product of an unconstitutional search.[50] The court said:

> Although restitution to a victim of crime is not a criminal punishment exacted by the state, it must nevertheless rest upon due process of law . . . . [It is] untenable to impose a requirement of restitution upon a defendant whose responsibility for the crime has neither been admitted nor established in accordance with due process.[51]

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[44] An extreme instance of reliance on such admissions is State v. Gerard, 57 Wis. 2d 611, 205 N.W.2d 374, *appeal dismissed*, 414 U.S. 804 (1973). At sentencing, the defendant admitted 20 uncharged burglaries and asked that they be read into the record because the district attorney had promised not to prosecute them. 205 N.W.2d at 379. The trial court ordered the defendant to make restitution for those offenses in the amount of $30,000 and the trial court's order was upheld on appeal. *Id.* at 381-82; *see* Harland, *Restitution Statutes and Cases*, *supra* note 25, at 155; *see also* State v. Baush, 83 N.J. 425, 416 A.2d 833, 839 (1980) (restitution inappropriate for unconvicted offenses because defendant had not been given opportunity to admit or deny validity of charge).

[45] 534 P.2d 1240 (Utah 1975).

[46] *Id.* at 1244.

[47] *Id.* at 1241.

[48] *Id.*

[49] 124 Ariz. 272, 603 P.2d 104 (Ct. App. 1979).

[50] 603 P.2d at 106.

[51] *Id.* at 107.

Despite the apparent agreement in these two cases, some interesting contrasts emerge. The Utah case seems to suggest that the only proof that will provide a basis for restitution is a criminal conviction. It points to the lack of allegations and proof of the unconvicted offenses "in the record" of the criminal case and to the coercion inherent in making a defendant pay an amount that has not been adjudicated. The Arizona case, on the other hand, treats restitution as "not a criminal punishment" because it is not "exacted by the state"—by which is presumably meant that it is not paid *to* the state—and implies that if the defendant is accorded "civil" due process in establishing his liability or if he admits his crimes, he may be required to make restitution for unconvicted offenses.[52]

The unmistakable trend in all jurisdictions is to uphold the use of restitution for unconvicted as well as convicted offenses if the defendant admits the unconvicted offenses. Statutory language has not been permitted to bind the scope of restitution tightly. When it seems to bind, the courts have looked to the underlying purposes of probation and restitution and plea bargaining to avoid the limitations.

C. The Notice Sanction and Class Actions

There are many offenses, particularly of the corporate and white collar variety, where the victims are unknown to the prosecutor or probation officer or the claims are so small that they may not be pressed by those officials. Such claims will never ripen into charges, formal or informal, that may be made the subject of admissions and, therefore, will never be included in a restitution order. The result is to leave defendants unjustly en-

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[52] In State v. Cummings, 120 Ariz. 69, 583 P.2d 1389 (Ct. App. 1978), the Arizona Court of Appeals stated:

> [T]he trial court properly exercised its discretion in ordering restitution for the prior burglary. The defendant has confessed to both burglaries and the amount of loss was verified by the company's records. The defendant within a short period of time has burglarized the same premises . . . . [A]n order directing restitution for all losses should have the salutory rehabilitative effect of forcing the defendant to accept the responsibility for his criminal behavior. It also has the beneficial effect of insuring repayment to the victim.

583 P.2d at 1391.

riched and victims uncompensated.

The proposed federal criminal code addresses this problem in an unusual provision that reduces the pressure to use unconvicted offenses as the basis for restitution in certain white collar crimes. It authorizes the court to use the criminal conviction as a means of triggering a civil class action. The triggering device is a "notice sanction" that the sentencing judge may impose upon (1) "an individual who has been found guilty of an offense involving fraud or other deceptive practices" or (2) "an organization that has been found guilty of any offense." Under the proposal, the "notice sanction" works as follows:

> [The court may order] that the defendant give notice and explanation of the conviction, in such form as the court may approve, to the class of persons or to the sector of the public affected by the conviction or financially interested in the subject matter of the offense, by mail, by advertising in designated areas or through designated media, or by other appropriate means.[53]

The above notice provision was intended not only to facilitate class actions for recovery of losses, it was also meant to reduce "the attractiveness of large-scale, profit seeking, deceptive practices."[54] The adverse publicity following upon such notice would tarnish the defendant's public image and serve as a deterrent to further crime—particularly to corporations that might count a loss to reputation as a more significant penalty than the payment of a fine or civil damages, which could be passed along to the consumer. Public notice would provide stockholders, consumers, and proxy victims with information that might be useful in changing corporate policies.[55]

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[53] S.1722, 96th Cong., 2d Sess. § 2005 (1980).

[54] The Senate report on the bill states that the "primary purpose" is to provide "notification to the persons injured by a multiple victim offense involving fraud or other intentionally deceptive practices that the perpetrator of the offense has been adjudged criminally responsible, and thereby to provide fair opportunity for civil recovery of damage to those with legitimate claims." S. REP. No. 553, 96th Cong., 1st Sess. 950 (1980). *See generally Developments in the Law—Class Actions*, 89 HARV. L. REV. 1318 (1976).

[55] The notice provision was originally directed principally at corporate offenders for whom "imprisonment is impossible and fines may be absorbed as a cost of doing business." *See* FINAL REPORT OF THE NATIONAL COMMISSION ON REFORM OF FEDERAL CRIMINAL

The concept of a notice sanction presents questions similar to those I have already discussed in the context of restitution. Who falls within "the class of persons" or the "sector of the public affected by the conviction or financially interested in the subject matter of the offense"? Is "the conviction" and "the offense" meant to refer to crimes that might have been charged and were not, or that were dismissed or bargained away, or that might be sustained in a civil proceeding? The problem may be illustrated by a typical fraud case. A corporation may have used fraudulent sales practices against two thousand people in six states. A federal prosecutor may have charged the corporation with fraud against twenty of these individuals in three states and obtained a guilty plea to one count of fraud in one state against five victims. Which of the defrauded persons is to be given notice? At a minimum, notice must be sent to the two thousand known victims in the six states—by mail or by advertising "or by other appropriate means." As to unknown victims, a supplementary hearing would have to be held as to the nature and extent of the "notice and explanation of the conviction" to be distributed and advertised.

Such a post-conviction hearing would unquestionably facilitate civil actions. Putting victims on notice that they have a claim, however, is merely one step along the path to recovery of damages. Other questions would remain, chief among them whether compensation to victims should be left to the vagaries of class action procedures, or whether it might not be preferable for the district attorney or some other public official to bring the class action on behalf of the relevant class of victims.

D. Some Problems of Procedure

All jurisdictions agree that there must be some sort of post-

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LAWS, A PROPOSED NEW FEDERAL CRIMINAL CODE 276; 1 WORKING PAPERS OF THE NATIONAL COMMISSION ON REFORM OF FEDERAL CRIMINAL LAWS 166; *see also* Schwartz, *Options in Constructing a Sentencing System: Sentencing Guidelines under Legislative or Judicial Hegemony*, 67 VA. L. REV. 637, 689 (1981) (discussing evolution of "shaming" procedures); Comment, *Increasing Community Control over Corporate Crime—A Problem in the Law of Sanctions*, 71 YALE L.J. 280, 303-04 (1964) (role of community in prosecution of corporate crime); *cf.* 15 U.S.C. §§ 1411-1412 (1976) (notification upon finding defect in motor vehicles).

conviction proceeding to determine the amount of restitution. The court, not the probation officer, must set the amount to be paid and the schedule of payment, though details, even including victims' names, are often developed by probation officers or referees. It is not settled, however, what procedures are to be used or whether they need satisfy standards of procedural due process. The most common view is that restitution is not a civil action to determine civil liability. It is part of the criminal proceedings, analogous in its nature to a pre-sentence investigation, and may follow "a summary procedural pattern."[56]

Most courts direct their probation officers to recommend the amount and then give the defendant an opportunity to contest the recommendation. Others base restitution on the evidence admitted at trial, or they hold an adversary hearing as a supplement to the trial of guilt—either following the procedure applicable to a civil trial and using the civil standard of preponderance of the evidence, or giving "notice, hearing and other elements [of due process] described in *Morrissey v. Brewer*."[57] Where restitution is involved in plea negotiations, it becomes a term of the plea agreement that the court must accept or reject, after a determination that it was entered into voluntarily.[58]

The courts have not been sensitive to the procedural issues involved in restitution, perhaps because many still treat probation (and restitution) as a "privilege," a "choice" the defendant makes freely in order to avoid prison.[59] They have often failed to put the defendant on notice as to what conduct might be made the basis for restitution or what procedures are to be followed in deciding the extent of his liability or deciding who qualifies as a victim. There has been little or no consideration of how genuine are the defendant's admissions of offenses for purposes of restitution despite the fact that they are made in the coercive con-

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[56] Harland, *Restitution Statutes and Cases*, *supra* note 25, at 157-59.

[57] *Id.* (citing Morrissey v. Brewer, 408 U.S. 471 (1972)); *see also, e.g.*, People v. Miller, 256 Cal. App. 2d 348, 356, 64 Cal. Rptr. 20, 25 (1967); People v. Gallagher, 55 Mich. App. 613, 223 N.W.2d 92, 95 (1974); State v. Harris, 70 N.J. 586, 362 A.2d 32, 37 (1976); State v. Scherr, 9 Wis. 2d 418, 101 N.W.2d 77, 80 (1960).

[58] State v. Bausch, 83 N.J. 425, 416 A.2d 833, 838-40 (1980).

[59] *See generally* Note, *Judicial Review of Probation Conditions*, 67 COLUM. L. REV. 181, 182-83 (1967); Note, *supra* note 43, at 467-73.

text of plea bargaining. The victim's role in these matters has received very little attention. Obviously, the issue of restitution revolves around the victim. He is in the best position to know the nature and extent of the offenses against him and the damage he has suffered. Yet, from a procedural point of view, he has been a silent beneficiary of a process that is controlled by others —the prosecutor, the probation officer, and the trial judge. With rare exceptions, he is at most a witness, at least until such time as a restitution order has already been entered.

Denying a voice to the victim is perhaps compatible with a concept of restitution that regards the measure principally as a means of rehabilitating the offender. But it is difficult to reconcile such denial with a rationale that makes reparation to the victim a primary or a major objective of sentencing. Yet many states have made just such a change in their sentencing objectives. An increasing number of statutes have been enacted that authorize an independent sentence of restitution that need not be tied to a rehabilitative purpose or even to release on probation. Instead, restitution has been placed on its own bottom, both as "a mechanism for restoring the victim financially" and as "a penal sanction . . . designed to require the offender to recognize his obligation to the victim of the offense directly." Under these statutes, it is a debt to the *victim* that is to be repaid, not a " 'debt to society.' "[60]

The new justification for restitution seems to contemplate a new status for the victim, one that calls into question whether there is any longer a basis for divorcing the so-called "private" interest of the victim in damages from the "public" interest in the criminal prosecution. From a comparative perspective, we may be evolving towards a system resembling the French *partie*

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[60] S. REP. NO. 553, *supra* note 54, at 954. The language in this report reflects a current that has been running for some time. *See, e.g.*, GA. CODE ANN. § 27-3001 (Supp. 1981) ("It is hereby declared to be the policy of this State that restitution by those found guilty of crimes to their victims is a primary concern of the criminal justice system."); N.M. STAT. ANN. § 31-17-1A (1981) ("It is a policy of this state that restitution be made by each violator of the Criminal Code . . . ."); *see also* AMERICAN LAW INSTITUTE, MODEL PENAL CODE § 7.02(3)(b) (Proposed Official Draft 1962) (expressing preference for payment of reparation to victim over payment of fine to state); AMERICAN BAR ASSOCIATION, STANDARDS FOR CRIMINAL JUSTICE 18-2.7(c)(iii) (1980) (same).

civile and the "adhesion" processes known to European systems. In France, the victim may bring a civil action for damages "directly caused by the offense" at the same time (and before the same court) as the criminal prosecution instituted by the state. In doing so, he obtains the results of the official investigation and becomes a party to the criminal case, with the right to submit evidence and arguments through his own counsel and to appeal from decisions adverse to him. A single case may then dispose of the civil and criminal claims.[61]

The issue now emerging for us, however, is a more limited one. Does the new victim orientation of restitution require the district attorney to act as the victim's surrogate on restitution? Or may the victim act on his own? Should it continue to be left to the public prosecutor to decide how energetically he will pursue restitution, or whether he will pursue it at all? If the victim is now intended to be a direct, perhaps even the primary, beneficiary of restitution, should he have a right to be heard on decisions that may deprive him of his restitution?

I shall argue that the victim deserves a voice in our criminal justice system, not only in hearings on the amount of restitution to be paid him but also on the offenses to be used as the basis for such restitution. I shall also urge, on broader grounds unrelated to restitution, that the victim should have a right to participate in hearings before the court on dismissals, guilty pleas, and sentences; this will lead to an exploration of the common assertion that the victim has no "standing" in criminal cases. Finally, I shall suggest that the victim should sometimes be permitted to proceed on his own through private prosecution.

III. A Voice for the Victim

The interest of the victim in restitution is clear. The injury for which financial compensation is sought is the injury to him. And the manifest legislative purpose is now as much to benefit him as to "correct" the offender. Yet the practice is to accord the victim no greater rights on the restitution issue than he has

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[61] A. Sheehan, Criminal Procedure in Scotland and France 20-23 (1978); Howard, *Compensation in French Criminal Procedure*, 21 Mod. L. Rev. 387, 387-89 (1958).

at trial and at earlier stages of the criminal process. Restitution is regarded as part of the proceedings on sentencing and only the prosecutor and the defendant have the right to participate. The victim is merely one member of a larger public that is represented by the district attorney. If the prosecutor is insensitive to the victim's interest, the restitution issue may be neglected entirely, the issue of damages may be presented poorly to the probation officer or the court at the restitution hearing, or the prosecutor may be inattentive to the implications for restitution of obtaining a conviction on one charge alone or on a minor charge. It may not occur to the prosecutor to use the negotiations on a guilty plea as an occasion at which other offenses—charged or uncharged—might be admitted by the defendant in order to broaden the basis for restitution.

There is no bar to the victim's presenting his views on these matters to the prosecutor, provided he is given a fair opportunity to do so. But if the prosecutor decides not to listen, the question arises as to whether the victim should have the right to participate in the restitution hearing itself on issues of damages. Should he have the right to participate even earlier at hearings on the guilty plea, when the judge must decide whether to accept or reject a plea agreement that may abandon offenses that might be made the basis for restitution? Should he have the right to participate in hearings on the prosecutor's motion to dismiss an offense or to reduce it from a major to minor one—because that decision will determine whether there can be any restitution, or how extensive it may be?

The victim currently is denied a formal role—party status—at each of these hearings. He has no right to present his views—the right of "allocution"—and he has no right to present evidence, to argue the issues, or to appeal. The victim's complaint may give rise to the prosecution and his testimony may be essential to sustain it, but he has no formal relation to the criminal case. The prosecutor alone is said to represent the public interest in criminal law. He has been endowed by the courts with a broad and virtually unreviewable discretion in these matters of charging and dismissal and restitution.[62]

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[62] *See* A. GOLDSTEIN, *supra* note 4, at 70-73; McDonald, *supra* note 2, at 659-65,

This "monopoly" of criminal prosecution by the district attorney is more the result of a misunderstanding of history than of explicit legislative direction. It traces to a time when the procedure for invoking criminal law was largely in private hands, as it is in England even today. When our system of public prosecution evolved, most statutes merely *authorized* the district attorney to prosecute all criminal cases in his county; they were silent as to whether the victim or anyone else could prosecute on his own. In a series of early opinions, however, the courts described the district attorney as exercising on the county level the powers of prosecution of the Attorney General of England whose actions could not be reviewed by the courts. From that historical analogy, the courts inferred that the district attorney's actions—particularly in deciding whether or not to initiate a prosecution —were also not reviewable.[63]

These opinions overlooked the fact that the English Attorney General was not a public prosecutor in our sense at all. Except for a limited class of cases, he did not initiate prosecutions. That was (and is) generally left to the victim and to the police as members of the public. He did have an unreviewable power in criminal cases—but only to enter a writ of *nolle prosequi.* That is, he could terminate prosecutions brought by private parties and the courts could not review his actions in doing so, and he could take over a private prosecution if he regarded it as in the public interest to do so. In short, the Attorney General of England exercised a *reviewing* authority over private prosecution, to assure that criminal processes and criminal sanctions were not used for harassment or in a manner inconsistent with the public interest.[64]

669-72.

There are occasional exceptions to the victim's lack of formal involvement with the criminal case. *See, e.g.,* State v. McIntyre, 33 N.C. App. 557, 235 S.E.2d 920, 923-24 (1977) (victim who was denied a share of a restitution fund permitted to petition for review and succeeded in setting order aside); State v. Scherr, 9 Wis. 2d 418, 101 N.W.2d 77, 81-82 (1960) (court allowed counsel for victim to take part in a reference proceeding to distribute a fund where participation occurred after trial and after defendant had been placed on probation).

[63] *See generally* McDonald, *supra* note 2, at 659-61.

[64] The history of the writ of *nolle prosequi* in England and the United States is discussed in A. GOLDSTEIN, *supra* note 4, at 12-24. For a discussion of private prosecution

The American historical error confused the power to intervene and dismiss cases already initiated by private parties with the exclusive power to decide whether they should be initiated at all. It transformed the assertion of the public interest at a secondary review stage into a rationale for total control of the initial stage, the charge itself. In the United States, victims trying to prosecute or participate in criminal cases came to be regarded as pursuing private interests; only district attorneys, therefore, could be entrusted with the conduct of criminal prosecutions.

A. The Victim and "Standing"

An historical error underlies the traditional position that denies to victims entirely the right to participate in criminal prosecution. Another error, more recent in origin, has compounded the problem. The opinion of the Supreme Court in *Linda R.S. v. Richard D.*[65] is said to deny to victims any "standing" in criminal cases. Though the case dealt only with a victim's effort to compel prosecution, the language used to deny the effort was very broad; the Court said, "[A] citizen lacks standing to contest the policies of the prosecuting authority when he himself is neither prosecuted nor threatened with prosecution."[66] The victim, said the Court, is "a private citizen [who] lacks a judicially cognizable interest in the prosecution or nonprosecution of another."[67]

Is a different position called for when the issue is not the initiation of prosecution but the proceedings subsequent thereto, that is, those bearing on restitution and sentencing after conviction and those bearing on dismissals and guilty pleas before conviction? A brief glance at the opinion in *Linda R.S.* demonstrates that it does not conclude either the matter ostensibly at issue in the case or the matter now being raised. The plaintiff had sought an injunction to compel a local district attorney in

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in England, see J. EDWARDS, LAW OFFICERS OF THE CROWN 237-46 (1964), and M. JACKSON, THE MACHINERY OF JUSTICE IN ENGLAND 155-57 (1972).

[65] 410 U.S. 614 (1973).

[66] *Id.* at 619.

[67] *Id.* at 614.

Texas to prosecute the father of her illegitimate child for nonsupport. The district attorney justified his refusal to prosecute on the ground that the statute applied only to fathers of legitimate children. The plaintiff contended that this was a "discriminatory application" of the nonsupport statutes, denying to her and her illegitimate child the equal protection of the laws under the fourteenth amendment. The Supreme Court did not reach either the issue of discrimination or the construction of the Texas statute. Instead, the Court held that the plaintiff lacked standing to sue in the absence of a statute that conferred standing:

> [The plaintiff has] made no showing that her failure to secure support payments results from the nonenforcement, as to her child's father, of Art. 602 . . . . [T]he statute creates a completed offense with a fixed penalty as soon as a parent fails to support his child. Thus, if appellant were granted the requested relief it would result only in the jailing of the child's father. The prospect that prosecution will . . . result in payment of support can, at best, be termed only speculative.[68]

The Court believed the plaintiff's only hope for support payments lay in the "speculative" effect a jail sentence might have on the defendant's conduct. Yet, in 1973, when the case was decided, the defendant might have been ordered to make child support payments upon conviction for nonsupport under two Texas procedures: (1) He could have been ordered to make child support payments as a condition of probation;[69] (2) The judge could have ordered him to serve a sentence during off-hours and on weekends so that he could continue his employment and designate a portion of his wages for the support of his dependents.[70] It appears, therefore, that if the district attorney had prosecuted the defendant, the Texas court could have ordered him to pay child support in the criminal case and there would have been a "direct nexus between the vindication of [the victim plaintiff's] interest and the enforcement of the state's criminal law."[71]

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[68] *Id.* at 618.

[69] *See* Olivas v. State, 168 Tex. Crim. 437, 328 S.W.2d 771, 771 (1959).

[70] TEX. CODE CRIM. PROC. ANN. art. 42.03 (Vernon 1979 & Supp. 1982).

[71] 410 U.S. at 619.

Even on its own premises, the Supreme Court did not try very hard to find "standing" for the plaintiff under the usual criteria. The challenged action had certainly caused her "injury in fact." The interest she sought to protect was as certainly "arguably within the zone of interests . . . regulated by the [nonsupport] statutes."[72] *Linda R.S.* was more a decision on the merits than on standing. The Court's cryptic reference to "the special status of criminal prosecutions in our system"[73] supports this view. The Court seems to have adopted a rule of construction that makes ours a system of public prosecution *unless* a legislature has said otherwise. Nevertheless, the explicit holding was based on a lack of standing to compel prosecution; the "special status of criminal prosecutions" was left to be explored another day.

There would seem to be little doubt that "standing" could be conferred on victims to participate in proceedings that have already been initiated or in sentencing and restitution hearings after conviction. Such "standing" could be conferred by the legislature. It could probably be authorized by the courts themselves, pursuing the themes of fairness and procedural due process. Even existing statutes might be construed as contemplating such participation. For example, the federal probation statute refers to the award of restitution to "aggrieved parties," which includes crime victims. If victims are parties for purposes of receiving the award, it would seem to follow that they could be made parties in order to determine the nature and size of the award. A similar construction might easily be adopted under statutes that make it clear, either in text or in legislative history, that restitution is a "primary" objective of the criminal conviction.

The issue that has most inhibited recognition of "standing" for the victim is the assumption that the status is a unitary one, and that once victims are allowed into post-charge proceedings, they would soon be authorized to contest the prosecutor's discre-

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[72] The language reflects the usual criteria. For discussions of "standing," see L. TRIBE, AMERICAN CONSTITUTIONAL LAW 79-114 (1978); Davis, *The Liberalized Law of Standing*, 37 U. CHI. L. REV. 450, 450-73 (1970); Jaffe, *Standing to Secure Judicial Review: Public Actions*, 74 HARV. L. REV. 1265, 1265-1314 (1961).

[73] 410 U.S. at 619.

tion to determine whether crime should be charged at all. Professor David Shapiro points out, however, that party "rights" need not be unitary:

> When one is granted intervention, either as of right or in the exercise of discretion, it does not necessarily follow that he must be granted all the rights of a party . . . including full rights of discovery and cross examination, the ability to veto a settlement of the case, and the right to appeal from a final decision. It is both feasible and desirable to break down the concept of intervention into a number of litigation rights and to conclude that a given person has one or some of these rights but not all.[74]

The Supreme Court opinion in *Trbovich v. United Mine Workers*[75] supports the view that there is no necessary conflict between retaining the prosecutor's exclusive authority to initiate a suit and providing a role for the victim in subsequent stages of the suit.[76]

In *Trbovich,* union members sought to intervene in a civil suit by the Secretary of Labor to set aside an election of officers by the United Mine Workers. After reviewing the legislative history, the Court held that the Secretary had been given the exclusive authority to initiate such actions for two reasons: "(1) to protect unions from frivolous litigation and unnecessary judicial interference in their elections, and (2) to centralize in a single proceeding such litigation as might be warranted with respect to a single election."[77] It saw no bar to participation by union members (the victims) in the Secretary's suit "so long as that participation did not interfere with the screening and centralizing function of the Secretary."[78] Because the union wished "only

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[74] Shapiro, *Some Thoughts on Intervention Before Courts, Agencies and Arbitrators,* 81 HARV. L. REV. 721, 727 (1968).

[75] 404 U.S. 528 (1972).

[76] *Id.* at 530-38. The court's authority to confer standing is weakest when it involves a suit to compel prosecution because that has been said by some courts to involve an "inherently executive" function and to raise questions of separation of powers. United States v. Cowan, 524 F.2d 504, 512-15 (5th Cir. 1975), *cert. denied,* 425 U.S. 971 (1976); *see* A. GOLDSTEIN, *supra* note 4, at 23.

[77] 404 U.S. at 532.

[78] *Id.* at 533.

to present evidence and argument in support of the Secretary's complaint,"[79] it could intervene. But it would not be permitted to add to the complaint other grounds for setting aside the elections; such additions would "circumvent the screening function assigned by statute to the Secretary."[80] The Court rejected the Secretary's contention that his representation of the union members' interests was sufficient, noting that his interests were inevitably dual in nature—he serves as lawyer for the union members in their complaint against the union and also serves a larger public interest. The Court stated:

> Even if the Secretary is performing his duties . . . as well as can be expected, the union member may have a valid complaint about the performance of "his lawyer." Such a complaint, filed by the member who initiated the entire enforcement proceeding, should be regarded as sufficient to warrant relief in the form of intervention . . . .[81]

The language and reasoning of *Trbovich* would seem to apply to the question whether the victim may intervene in the restitution hearing, or even in dismissal and guilty plea and sentencing hearings, *if* he was meant to have a special stake in those processes and if his interests might otherwise be neglected. The prosecutor's screening and centralizing function having been discharged by choosing the charges on which to prosecute, there would seem to be no bar to permitting the victim to intervene.

B. The Prosecutor's Authority and the Victim's Role

The question raised by the new statutes and the arguments for a restitutive theory of justice is whether the public prosecutor should share his authority with the victim of crime, and at what stages of the process. To answer that question, I will have to discuss public prosecution as we know it.

There are unquestionably good reasons for assigning the prosecution role entirely to the district attorney. He is said to be more impartial and less vindictive than the victim or members

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[79] *Id.* at 537.
[80] *Id.*
[81] *Id.* at 539.

of the general public who might seek prosecution. He has a surer sense of which laws might be applicable to offensive conduct and, where they conflict, which of them might be applied in a particular case. Moreover, by centralizing the charging decision in him, norms of equality and rationality are more likely to be served, as in the increasingly important "screening" or gatekeeping function of assuring—either by guilty pleas or trials or places in penal instituions—that no more cases move into the judicial system than it can handle.

Yet these are plainly oversimplifications. The prosecutor is not merely a representative of public justice. He is an official administering a bureaucracy that serves a variety of objectives —investigative, adjudicative, administrative, and political. However high-minded he may be in exercising his function, his roles as advocate and administrator make it difficult for him to be genuinely neutral, and to weigh impartially the facts and law and equities bearing on the many decisions he must make. When he pursues an investigation with or without the police, he is a partisan engaged in the "competitive enterprise of ferreting out crime."[82] The Supreme Court said in *Coolidge v. New Hampshire*[83] that, under such circumstances, the prosecutor is not impartial enough to pass on the sufficiency of a search warrant.[84] In *Gerstein v. Pugh*,[85] the Court held that an information drafted by a prosecutor is not "judicial" enough to provide an objective guarantee of probable cause comparable to that furnished by a grand jury.[86]

When he functions as an administrator, the prosecutor's concerns may also focus less on justice in the particular case than on using his resources and the court's time effectively. The rape case may be reduced to indecent assault and the street robbery to larceny; multiple burglary offenders may be charged with only one offense; and many offenses are not prosecuted at all because they fall into the "nuisance" category—the cases of battered wives and battered children and battered sweethearts,

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[82] Johnson v. United States, 333 U.S. 10, 14 (1948).
[83] 403 U.S. 443 (1971).
[84] *Id.* at 449.
[85] 420 U.S. 103 (1975).
[86] *Id.* at 117.

neighborhood disputes, bad checks, and consumer frauds. Prosecutors regard themselves as authorized to pursue their own administrative course concerning their case loads, their policy preferences as to the relative importance of the crime charged, the correctional dispositions to be sought, and the extent to which they should trade immunity from prosecution for information to be used in other cases.

The prosecutor's authority to do these things—to ignore crimes, assume correctional powers, and confer immunities—has not been conferred directly by the legislature. It is at best an assertion of "inherent power," acquiesced in by the courts over the years but rarely dealt with in any detail. This authority can cause serious problems in the administration of criminal justice. By the time a file is closed, it may not be clear to anyone what a conviction—or a dismissal—stands for. How are the probation officer and sentencing judge, prison adminstrators, and parole officials to regard the person described in the presentence report as a rapist if he was merely convicted of indecent assault? And how are they to regard the street robber who was convicted of larceny? How is the statistician of crimes to count them? How is an attending public of potential offenders to be deterred from rape or robbery or burglary when the "real offense" has so often been transformed into a lesser crime? And what of the victim who sees his injury converted into something else in disregard not only of his feelings but also of his claim to restitution?

We usually think of the adversary process as providing the necessary counterweight to the prosecutor. But this is not likely to occur when decisions are made on charges and guilty pleas. By the time most such matters are presented to a court, defense counsel and prosecutor are in agreement and have a considerable stake in blurring the underlying facts. The usual check on official power provided by an adversary system is simply not operative in such administrative and consensual settings.

Nor can the judge alone be relied on to see to it that such agreements are consistent with the public interest. Though approval is necessary before charges can be reduced or dismissed, guilty pleas accepted or rejected, the judge cannot easily know whether the charge presented to him by the parties (as the basis for a guilty plea) is an accurate reflection of the facts of the case,

or whether it really is necessary to reduce the charge from rape to indecent assault, or from robbery to larceny. He cannot easily know the nature of the injury done to the victim or the appropriateness of the sentencing range left to him unless one or the other party tells him. When consensus has been reached by the parties, he must get assistance from someone who has a genuine interest in the proceedings. The victim is plainly such a person.

I would bring the victim into the system by authorizing him to participate as a party (not merely as having a right of "allocution") after conviction, on issues connected with restitution and sentencing, and before conviction, in hearings on dismissals, charge reductions, and guilty pleas.[87] Placing the victim in the process as a party would force the prosecutor to justify to the court his decison not to proceed, or to proceed on assumptions about the facts and the law that differ from the victim's account. It would provide the judge with a party who has a genuine interest in challenging and correcting the version of fact and law proferred by the prosecutor or defense counsel or both.[88]

There are serious problems in giving "rights" to the victim. The criminal justice system is already so burdened that it may not be able to stand any change that might require more time and more money. Victims may be too vindictive, and may want full enforcement, more charges, and heavier sentences when less-than-full enforcement would better serve the public interest. There is evidence, however, that the risk of added vindictiveness is overstated. Victims are even more varied than the crimes committed against them. In the vast number of regulatory offenses, the "victim" is often the public agency vested with primary responsibility for protecting a segment of the public interest. As

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[87] *See* M. FLEMING, OF CRIMES AND RIGHTS 161-63 (1978); A. GOLDSTEIN, *supra* note 4, at 70-73. A New Mexico statute specifically provides that the defendant or the victims may obtain a hearing on any matter related to the restitution plan recommended by the probation officer to the court. N.M. STAT. ANN. § 31-17-1 (1978). *See generally Victim/Witness Legislation: Considerations for Policymakers, supra* note 14, at 46-49.

[88] The initial charging decision falls into a more inviolate category than decisions made at subsequent stages. *See supra* note 76. But there is nothing to prevent a prosecutor from routinely inviting the victim (and his counsel) to a pre-charge conference and soliciting his views on what the charge should be. *See generally* A. GOLDSTEIN, *supra* note 4, at 70-73 (victim should participate on issues connected with restitution and sentencing).

noted earlier, in more conventional cases, the criminal charge is little more than a point of entry for troubled people seeking solution to a remarkable range of "civil" problems. Giving such victims a stake in the criminal process may be a way to reduce retributive impulses and at the same time direct the parties to processes of mediation and conciliation that may be an alternative to relying on imprisonment, particularly when the processes are augmented by financial settlement procedures and injunctive relief.[89]

An entirely different set of problems is presented by crimes of violence unmitigated by prior relationship and by crimes involving serious invasions of property, thefts above the nuisance level, and corruption. These crimes are too little enforced, often because the victim is unwilling to cooperate in a prosecution that no longer seems to have much relation to him. If the credibility of the criminal sanction is to be maintained, the victims of such crimes must be persuaded to cooperate, even if they are moved to do so by vindictive feelings. Victim involvement at critical stages may supply the missing link.

C. A Return to Private Prosecution?

There are now too many crimes and too few resources to try them all. Why, under such circumstances, should the victim not be authorized on occasion to initiate the criminal case himself, drawing on the system of private prosecution with which English and American criminal justice began? Though the public prosecutor now controls the charging power in the United States, remnants of private prosecution still exist. In a few jurisdictions, minor offenses may be prosecuted directly by victims or by regulatory agencies serving as proxy victims.[90] In a larger number,

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[89] D. McGILLIS & J. MILLER, NEIGHBORHOOD JUSTICE CENTERS 10-25 (1977); *see* VERA INSTITUTE OF JUSTICE, *supra* note 11, at 135-40; Rice, *Mediation and Arbitration as a Civil Alternative to the Criminal Justice System—An Overview and Legal Analysis*, 29 AM. U.L. REV. 17, 18-21 (1979).

[90] *See* People v. Van Sickle, 13 N.Y.2d 61, 62-63, 192 N.E.2d 9, 10, 292 N.Y.S.2d 34, 35 (1963); Allen v. Citadel Management Co., 78 Misc. 626, 355 N.Y.S.2d 976, 978 (Crim. Ct. 1974); People v. Kramer, 33 Misc. 209, 68 N.Y.S. 383, 391 (Ct. Gen. Sess. 1900). In Wisconsin, private parties may prosecute for "assault and battery or for the use of language intended or naturally tending to provoke an assault or breach of the peace." WIS.

counsel for the victim may assist the public prosecutor in the preparation and even in the trial of the criminal case, with the victim's counsel sometimes acting entirely alone. The courts have rejected challenges to convictions in such cases by describing counsel as exercising authority "delegated" to him by the district attorney or as being "supervised" by the district attorney even when that official was not present.[91]

Would it be desirable to draw on some of these practices and encourage the district attorney to delegate some of his authority to victims or proxy victims? The effect of such delegation would be to make the American public prosecutor even more like his historical predecessor, the Attorney General of England. He would become both a public prosecutor *and* a supervisor of private prosecution, reserving his own resources for the most serious cases and for those that could not, or would not, be prosecuted privately.

There are some obvious categories of cases in which, under current conditions, private enforcement may be more likely to occur than public enforcement. These include the crimes among friends and neighbors who assault and steal from each other, the crimes committed by business people who cheat and defraud their customers and clients, the crimes of strict liability involving health and safety, and "public torts." There are institutional candidates for private prosecution as well: retail stores in shoplifting cases; banks in embezzlement cases; public health and safety agencies assuming the role of proxy victims under regulatory statutes; public interest groups, trade associations, and labor unions serving as proxy victims and attending to the criminal law enacted out of concern for their constituents.[92]

A system combining private prosecution with some degree

STAT. ANN. § 59.47 (West 1965); *see* Note, *Statutory Discretion of the District Attorney in Wisconsin*, 1953 WIS. L. REV. 170, 170.

[91] Hall, *supra* note 4, at 974-78; *see* Note, *Private Prosecution: The Entrenched Anomaly*, 50 N.C. L. REV. 1171, 1172-73 (1972).

[92] *See* OR. REV. STAT. § 30.875 (1979) (providing that shoplifters are liable to store owner for actual damages, plus a penalty of retail value up to $500, plus an additional penalty not less than $100 and not more than $250); *see also* Robin, *The Corporate and Judicial Disposition of Employee Thieves*, 1967 WIS. L. REV. 685, 688 (discussing prosecution of employees by employers for shoplifting).

of public control can easily be imagined. It might, for example, permit the private prosecutor to invoke the criminal law by filing a complaint before a magistrate, with notice to the district attorney so that he may serve a "screening and centralizing" function even as he delegates prosecution to others.[93] If there is probable cause, the prosecution would continue unless the prosecutor intervened and sought to dismiss the case or to prosecute it himself. His decision to prosecute would be unreviewable and his motion to dismiss a private prosecution would prevail if he had rationally persuasive grounds for dismissal. In time, the prosecutor would probably develop criteria for the classes of cases he would allow routinely to be brought by private parties, as well as those he would take over or move to dismiss. In such a system, it would be essential to provide flexible remedies as alternatives to imprisonment, not only to reduce the strain on public resources but also because the key to minor criminal cases of the sort most appropriate for private prosecution is often found in "civil" remedies, mediation, and arbitration.

The role I have defined for the victim is no panacea. If we adopt it, we will have to control and moderate it, as we do the roles of other participants in the criminal process. A great deal remains to be said, for example, about the fairness of damages awarded as restitution when they are paid to avoid imprisonment; about the extent to which private prosecution increases the risk of harassment and malicious prosecution; and about the effect on the defendant of providing greater rights for the victim. My purpose, however, has been not to exhaust the issues but to put some of them fairly before you. The victims' movement cannot be dismissed as a regressive development that threatens only to unleash dark and ungovernable forces, for it can serve also to remind us that any system of criminal law depends ultimately upon its credibility. We cannot safely ignore

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[93] *See* Comment, *Private Prosecution: A Remedy for District Attorneys' Unwarranted Inaction*, 65 YALE L.J. 209, 224 (private prosecution in Scotland is commonly conducted with the approval of public prosecutor, and if he refuses to allow such action or to proceed himself, a court may authorize the private prosecution).

the fact that legal norms will be perceived as valid only if they are made credible by enforcement, that such credibility rests on the willingness of victims to complain, and that the victim will withhold his complaint if he believes the system will ignore him. In the revival of interest in financial reparation for the victim and in the steady movement from victim/witness to victim/involvement programs, we are witnessing a significant change in the orientation of our system of criminal justice—one that need not care less for the offender simply because it now tries to make greater provision for the victim.

I have argued that we should move beyond notification and information to victims, even beyond a mere right of "allocution," to a genuine right of victims to participate as parties in those parts of the process where the adversary system is not working and where they can make a special contribution, or where they have a special stake, as in restitution. The purpose is not only to make the victim feel better but also to assure fuller consideration of issues of accuracy and legality where there is a risk that such issues will be submerged by the pressures of bureaucracy and politics and plea bargaining. Will these suggestions put a further strain on the criminal justice system? If restitution is used more—and particularly if it expands into community service by the indigent, so that it may reach theft offenders—it may become an important alternative to imprisonment. The same is true if private prosecution is used as a device for decriminalization, as a means of channeling cases from criminal to civil processes. The greater amount of time devoted to the victim may then be counteracted by a decreased need for imprisonment. As to the serious offenses, if more attention to victims' rights produces more convictions, we should be willing to pay the price.

A SURVEY AND ANALYSIS OF COMPARATIVE FAULT IN MISSISSIPPI

*Olger C. Twyner, III**

The Mississippi Legislature took a revolutionary step in 1910 by enacting the first general comparative negligence statute in the United States.[1] Significantly, the statute embraced the "pure" comparative fault doctrine, which not only eliminates the defense of contributory negligence, but also enables a plaintiff to recover damages regardless of his degree of fault.[2] Since 1910, there have been a number of interesting developments in Mississippi's comparative fault doctrine. This article briefly reviews the history of comparative fault in England and America,[3] but focuses primarily on Mississippi law. The vestiges of the contributory negligence defense that remain in Mississippi will be discussed,[4] as well as the expansion and contraction of comparative fault principles in the state. A survey of the Mississippi Supreme Court's treatment of the comparative fault doctrine is included as well. Although this article is not intended to be an exhaustive exposition of comparative fault in Mississippi, it will analyze several important comparative fault issues in the state.

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[1] Act of April 16, 1910, ch. 135, § 1, 1910 Miss. Laws 125 (codified at MISS. CODE ANN. § 11-7-15 (1972)); *see infra* text accompanying notes 57-62.

[2] The doctrine of "pure" comparative negligence provides that the contributory negligence of a plaintiff is no longer a bar to recovery unless it is the sole proximate cause of the harm suffered. A plaintiff's recovery is reduced in proportion to his fault. MISS. CODE ANN. § 11-7-15 (1972); *see* Sowle & Conkle, *Comparative Negligence Versus the Constitutional Guarantee of Equal Protection: A Hypothetical Judicial Decision*, 1979 DUKE L.J. 1083, 1139 (pure comparative negligence represents most equitable method of allocating damages in negligence action.) *See generally* W. PROSSER, THE LAW OF TORTS § 67, at 433-39 (4th ed. 1971).

[3] *See infra* notes 5-56 and accompanying text.

[4] *See infra* notes 63-91 and accompanying text.

I. Historical Background

A. Contributory Negligence

An examination of comparative fault properly begins with a look at contributory negligence. Contributory negligence is "conduct on the part of the plaintiff, contributing as a legal cause to the harm he has suffered, which falls below the standard to which he is required to conform for his own protection."[5] *Butterfield v. Forrester*[6] is considered to be the earliest contributory negligence case.[7] In *Butterfield,* the plaintiff was injured when the horse he was riding struck a pole that the defendant had negligently placed across the public road.[8] Based on evidence presented in the trial court showing that the pole could be seen one hundred yards away, Judge Barley instructed the jurors to find for the defendant if they concluded that a person riding with reasonable and ordinary care would have seen and avoided the obstruction, and if they were satisfied that the plaintiff was not riding with ordinary care.[9] The jury held for the defendant.[10] Lord Ellenborough affirmed the verdict, stating: "[O]ne person being in fault will not dispense with another's using ordinary care for himself. Two things must concur to support this action, an obstruction in the road by the fault of the defendant, and no want of ordinary care to avoid it on the part of the plaintiff."[11]

The 1824 Massachusetts case *Smith v. Smith*[12] was the first in the United States to adopt the contributory negligence defense. In that case, the plaintiff's horse was injured and wagon was damaged when the wagon struck a woodpile placed alongside, and protruding into, the road by the defendant.[13] The plaintiff's employee was driving down the road at night when, after failure of the wagon's harness, the wagon struck the wood-

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[5] W. Prosser, *supra* note 2, § 65, at 416-17.
[6] 103 Eng. Rep. 926 (K.B. 1809).
[7] W. Prosser, *supra* note 2, § 65, at 416 n.1.
[8] 103 Eng. Rep. at 926.
[9] *Id.* at 927.
[10] *Id.*
[11] *Id.*
[12] 19 Mass. (2 Pick.) 621 (1824).
[13] *Id.* at 622.

pile.[14] The driver—who saw the woodpile when the wagon was still twenty feet from it—claimed that if the woodpile had not been there the harness failure would have occasioned no injury.[15] The plaintiff was ordered to show that the driver used ordinary care or be barred from recovery.[16] The court, reaching a conclusion similar to that in *Butterfield,* found that the plaintiff's contributory negligence barred his recovery.[17] Subsequently, the contributory negligence doctrine was adopted in all fifty states.[18]

Soon after it's development, the contributory negligence defense proved to be quite harsh in its application.[19] An injured plaintiff, even if only slightly negligent, would be barred from recovery against a defendant, regardless of the defendant's degree of fault.[20] In order to avoid this harsh result, the "last clear chance" exception to the bar of contributory negligence evolved.[21] Under this exception, if a defendant had the last clear chance to avoid an accident, a plaintiff's contributory negligence will not bar his claim.[22] In *Davies v. Mann,*[23] the defendant drove his horse and wagon into the plaintiff's donkey that had been left in the highway. The court determined that the defendant was negligent because of the careless and unskillfull manner in which he had driven his wagon.[24] In addition, the court found the plaintiff negligent because he had fettered the fore feet of his donkey and had left the animal grazing in the highway.[25] But, because the defendant had had the last clear chance to avoid the collision, the plaintiff was allowed to recover the value of his loss.[26]

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[14] *Id.*

[15] *Id.*

[16] *Id.*

[17] *Id.* at 624.

[18] 57 AM. JUR. 2D *Negligence* § 288, at 684 & n.14 (1971).

[19] *See* W. PROSSER, *supra* note 2, § 67, at 433 (doctrine places upon one party the entire loss for which two caused).

[20] *Id.*

[21] *See* V. SCHWARTZ, COMPARATIVE NEGLIGENCE § 1.2(A), at 5 (1974).

[22] W. PROSSER, *supra* note 2, § 66, at 427.

[23] 152 Eng. Rep. 588 (Ex. 1842). Dean Prosser places the origin of the last clear chance doctrine with *Davies v. Mann.* W. PROSSER, *supra* note 2, § 66, at 427.

[24] 152 Eng. Rep. at 588.

[25] *Id.*

[26] *Id.* at 589.

As dissatisfaction with the contributory negligence defense spread, other methods of circumventing it emerged.[27] One method used to limit the adverse consequences of contributory negligence was to send a case to the jury.[28] A judge acting as the trier of fact is compelled to apply the letter of the law, while a jury is more likely to apply its own lay standard of comparative negligence in a contributory negligence case.[29] Also, some courts have held that a defendant's gross or wanton negligence was sufficient to avoid the contributory negligence defense.[30] The catalog of other limitations placed on the contributory negligence bar included refusing to apply the doctrine to intentional tort cases and to strict liability cases.[31] These modifications, however, proved to be just as harsh as the contributory negligence bar because a negligent plaintiff could recover his entire damages in a case.

B. Comparative Fault

The theory that damages in a tort action should be apportioned on the basis of fault has been traced as far back as the Mosaic Law.[32] For example, if an ox killed the ox of another, both the live and dead oxen were sold, and the proceeds were then divided between the two owners.[33] In ancient Rome, the great *Digest of Justinian,* completed in 533 A.D., ambitiously undertook to assemble in one work all Roman law.[34] The *Digest* provided that an individual should assume damages in propor-

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[27] *See generally,* H. WOODS, THE NEGLIGENCE CASE: COMPARATIVE FAULT § 1:6 (1978).

[28] V. SCHWARTZ, *supra* note 21, § 1.2, at 6.

[29] *See* J. ULMAN, A JUDGE TAKES THE STAND 32-34 (1936).

[30] H. WOODS, *supra* note 27, § 1:6, at 12; *see, e.g.,* Reserve Trucking Co. v. Fairchild, 128 Ohio St. 519, 191 N.E. 745, 749 (1934) (contributory negligence is no defense to charge of willful misconduct); *see also* RESTATEMENT (SECOND) OF TORTS § 503(1) (1965) (plaintiff's contributory negligence no bar to recovery for harm resulting from defendant's reckless disregard for plaintiff's safety).

[31] H. WOODS, *supra* note 27, § 1:6, at 12-13; *see, e.g.,* Ballew v. Asheville & E.T.R.R., 186 N.C. 703, 120 S.E. 334, 335 (1923) (contributory negligence defense has no application in intentional tort actions).

[32] Turk, *Comparative Negligence On The March,* 28 CHI.[-]KENT L. REV. 189, 208 (1950).

[33] *Id.* at 208.

[34] H. WOODS, *supra* note 27, § 1:9, at 17.

tion to his fault, and when it was difficult to determine fault, damages were to be divided equally.[35] In English jurisprudence, the doctrine of comparative fault has been applied in admiralty cases since the 1700's.[36] Additionally, the admiralty courts of other nations evidenced dissatisfaction with the common law rule of contributory negligence[37] and formulated their own rules governing losses at sea. One rule, known as the "division of loss" rule, provided that when two ships collided and both parties were at fault, each party was to be assessed one-half of the total damages.[38] Application of this rule was limited to cases where both parties were clearly at fault or cases of "inscrutable fault," in which the court was unable to ascertain the amount of fault attributable to each party.[39] Another admiralty rule based on apportionment of damages provided that when two or more vessels collided and all were at fault, the liability for property damage caused by the collision was divided in proportion to each vessel's degree of fault.[40] This rule, established by the Brussels International Maritime Convention in 1910 and incorporated into the English Maritime Act of 1911, is now applied in United States admiralty cases.[41]

The second Federal Employers' Liability Act of 1908[42] (FELA) provided the first significant federal comparative fault

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[35] Mole & Wilson, *A Study of Comparative Negligence* (pt. 1), 17 CORNELL L.Q. 333, 337 (1932) (citing DIG. JUST. 50.17.203).

[36] *See* Mole & Wilson, *supra* note 35, at 334-43.

[37] *Id.* at 339.

[38] *Id.* The United States Supreme Court adopted this rule in The Schooner Catharine v. Dickinson, 58 U.S. (17 How.) 170, 177-78 (1855).

[39] Mole & Wilson, *supra* note 35, at 339 n.21; *see, e.g.*, The Tracy J. Bronson, 24 F. Cas. 119, 120 (N.D.N.Y. 1869) (No. 14,131) (damages divided in schooner collision where conflict as to wind direction rendered fault determination impossible); Lucas v. The Thomas Swann, 15 F. Cas. 1065, 1066 (D. Ohio 1854) (No. 8588) (damages apportioned equally where position of steamboats could not be ascertained).

[40] Maritime Conventions Act, 1911, 1 & 2 Geo. 5, ch. 57, at 454; *see* Franck, *Collisions at Sea in Relation to International Maritime Law*, 12 LAW Q. REV. 260, 260-65 (1896) (advocating adoption of apportionment of loss rule as most equitable rule, both theoretically and practically). *See generally*, Mole & Wilson, *supra* note 35, at 339-40.

[41] *See* United States v. Reliable Transfer Co., 421 U.S. 397, 411 (1975) ("division of loss" rule replaced by rule of apportionment).

[42] Employers' Liability Act, ch. 149, 35 Stat. 65 (1908) (codified as amended at 45 U.S.C. §§ 51-59 (1976)).

legislation in the United States.[43] The FELA was a reaction to common law defenses such as contributory negligence, which had led to many unjust results in suits by railroad employees against their employers.[44] The Death on the High Seas Act of 1920[45] and the Merchant Marine (Jones) Act of 1920[46] embraced the doctrine of pure comparative negligence in personal injury or death actions by seamen or their personal representatives against their employers.

The common law rule of contributory negligence also proved too harsh in the master-servant context, because an employee's claim could be barred by even slight negligence on his part.[47] Remedies for work-related injuries were inadequate and inconsistent with modern conditions.[48] In response to growing pressure from laborers for protective legislation, workers' compensation laws were passed in several states.[49]

In 1910, Mississippi passed the first comparative negligence statute that applied to all actions involving physical injury.[50] The state adopted "pure" comparative negligence, which does not bar a plaintiff's claim regardless of his degree of fault.[51] Another form of comparative negligence, the fifty percent/fifty per-

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[43] *See* Foster, *The Federal Employers' Liability Act as Construed by the Supreme Court*, 1 So. L.Q. 230, 235 (1916).

[44] *See* Trieber, *The National Employers' Liability Act*, 49 AM. L. REV. 481, 506 (1915) (noting traditional inequality of bargaining position between railroad and its employees).

[45] Death on the High Seas Act, ch. 111, § 1, 41 Stat. 537 (1920) (codified as amended at 46 U.S.C. §§ 761-768 (1976)).

[46] Merchant Marine (Jones) Act, ch. 250, § 1, 41 Stat. 988 (1920) (codified as amended at 46 U.S.C. §§ 861-888 (1976)).

[47] 1 A. LARSON, WORKMEN'S COMPENSATION LAW § 4.30 (1978).

[48] Mole & Wilson, *A Study of Comparative Negligence* (pt. 2), 17 CORNELL L.Q. 604, 604 (1932).

[49] *Id.* at 604-05. Wisconsin's law went into effect on May 3, 1911, the first state law to do so. U.S. BUREAU OF LABOR STANDARDS, DEP'T OF LABOR, LABOR LAW SERIES No. 10, SUMMARY OF STATE WORKMEN'S COMPENSATION LAWS 1 (1970). Under workers' compensation laws, a jury diminishes an employee's recovery in proportion to the negligence attributable to him. Despite this diminution, the employer, in effect, is held strictly liable for job-related injuries. *See* MISS. CODE ANN. § 11-7-15 (1972).

[50] Act of April 16, 1910, ch. 135, § 1, 1910 Miss. Laws 125 (codified at MISS. CODE ANN. § 11-7-15 (1972)).

[51] *See, e.g.*, Mississippi C.R.R. v. Robinson, 106 Miss. 896, 908, 64 So. 838, 842 (1914); Yazoo & M.V.R.R. v. Carroll, 103 Miss. 830, 835, 60 So. 1013, 1014 (1913).

cent form, was adopted by Wisconsin in 1931.[52] The Wisconsin statute allowed a plaintiff to recover only if his negligence was not as great as that of the defendant.[53] In 1969, New Hampshire passed a forty-nine/fifty-one percent comparative negligence statute.[54] Under this approach, a plaintiff may recover provided his negligence is not greater than that of the defendant.[55] Presently, forty states and Puerto Rico have adopted, either legislatively or judicially, some form of comparative negligence.[56]

C. Comparative Fault in Mississippi

It has been suggested that the Mississippi Legislature enacted the comparative negligence statute in 1910 "with an eye toward" the Federal Employers' Liability Act and other state workers' compensation laws.[57] Indeed, passage of the comparative negligence statute, coupled with a slow rate of industrialization and urbanization in Mississippi, forestalled the need for enactment of a workers' compensation law in Mississippi until 1948.[58] Also, older members of the Mississippi Bar have contended that the driving force behind the adoption of a comparative negligence statute was a small group of plaintiffs' attorneys who were constantly facing directed verdicts for defendants because of the common law bar of contributory negligence.[59]

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[52] Act of June 15, 1931, ch. 241, 1931 Wis. Laws 375 (codified as amended at WIS. STAT. ANN. § 895.045 (West 1966 & Supp. 1981)).

[53] WIS. STAT. ANN. § 895.045 (West 1966) (amended 1971). The Wisconsin statute presently reads: "Contributory negligence shall not bar recovery . . . if such negligence was not greater than the negligence of the person against whom recovery is sought." *Id.* (West 1966 & Supp. 1981). Thus, the statute became a 49%/51% comparative negligence law.

[54] Act of June 13, 1969, ch. 225, 1969 N.H. Laws 177 (codified at N.H. REV. STAT. ANN. § 507:7-a (Supp. 1979)).

[55] *See, e.g.*, Macon v. Seaward Constr. Co., 555 F.2d 1, 1-3 (1st Cir. 1977).

[56] *See* C.R. HEFT & C.J. HEFT, COMPARATIVE NEGLIGENCE MANUAL 2-3 app. II (1978); Sowle & Conkle, *supra* note 2, at 1087 n.9.

[57] Note, 39 MISS. L.J. 493, 498 (1969).

[58] Prior to World War II, Mississippi was primarily an agricultural state. The comparative negligence statute was sufficient to handle the small number of claims arising out of work-related accidents. With the growth of the sawmill and the oil and gas industries, however, the need for more pervasive legislation covering workers' claims grew. *Id.*

[59] Shell & Bufkin, *Comparative Negligence in Mississippi*, 27 MISS. L.J. 105, 105 (1956).

The original comparative negligence statute was amended in 1920 to include actions brought for injury to property, in addition to actions for personal injury and death.[60] The statute currently provides:

> In all actions hereafter brought for personal injuries, or where such injuries have resulted in death, or for injury to property, the fact that the person injured, or the owner of the property, or person having control over the property may have been guilty of contributory negligence shall not bar a recovery, but damages shall be diminished by the jury in proportion to the amount of negligence attributable to the person injured, or the owner of the property, or the person having control over the property.[61]

Moreover, the Mississippi Code further provides, "All questions of negligence and contributory negligence shall be for the jury to determine."[62]

II. Scope and Application of Comparative Fault in Mississippi

A. *Vestiges of Contributory Negligence: Last Clear Chance*

The last clear chance doctrine emerged to help an injured party avoid the harsh consequences that resulted when that party was guilty of contributory negligence.[63] Prior to the adoption of the comparative negligence statute in Mississippi, last clear chance was an exception to the contributory negligence bar in the state.[64] Dean Prosser has noted that with the adoption of a comparative negligence statute, it would appear that "any necessity for the last clear chance as a palliative of the hardships of contributory negligence obviously disappears."[65] Recognition

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[60] Act of March 25, 1920, ch. 312, § 1, 1920 Miss. Laws 441 (codified at Miss. Code Ann. § 11-7-15 (1972)).

[61] Miss. Code Ann. § 11-7-15 (1972).

[62] *Id.* § 11-7-17.

[63] Note, *supra* note 57, at 498 (citing Davies v. Mann, 152 Eng. Rep. 588 (1842)); *see supra* notes 21-26 and accompanying text.

[64] *See, e.g.*, Christian v. Illinois C.R.R., 71 Miss. 237, 240, 12 So. 710, 711 (1893).

[65] W. Prosser, *supra* note 2, § 67, at 439.

of such lack of necessity has not been the case in Mississipi, however, and the present status of the last clear chance doctrine in the state is unclear.[66]

Following the adoption of the comparative negligence statute in 1910, the last clear chance doctrine did not form the basis for any reported decision involving Mississippi law for over forty years.[67] Indeed, it appeared that the last clear chance plea "ha[d] fallen into disfavor with both counsel and the courts in Mississippi."[68] In 1953, however, the United States Court of Appeals for the Fifth Circuit, in *Underwood v. Illinois Central Railroad,*[69] held that the last clear chance doctrine was still alive in Mississippi. *Underwood* involved an action by a motorist and his passenger for injuries sustained in a railroad crossing accident. The United States District Court for the Southern District of Mississippi, which had relied on cases not involving the last clear chance doctrine, and had subsequently directed a verdict for the railroad company, was reversed by the Fifth Circuit. The Fifth Circuit determined that the question whether the engineer of the train had the last clear chance to avoid the accident was for the jury to decide.[70] The Fifth Circuit concluded that the doctrine of last clear chance "is firmly imbedded in the jurisprudence of Mississippi."[71]

After remand and a second trial, this case again appeared before the Fifth Circuit as *Illinois Central Railroad v. Underwood.*[72] The Fifth Circuit retreated from its previous decision, stating that the Mississippi last clear chance doctrine "loses most of its meaning and importance" because of comparative negligence.[73] Nevertheless, the court implied that last clear

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[66] *See* Newman v. Missouri P.R.R., 421 F. Supp. 488, 492 (S.D. Miss. 1976) (in "no Mississippi case, concluded on its merits, [has] the contributory negligence of a plaintiff . . . minimized damages in the face of . . . defendant [having] last clear chance"). *But cf.* New Orleans & N.E.R.R. v. Dixie Highway Express, Inc., 230 Miss. 92, 94, 92 So. 2d 455, 456 (1957) (application of last clear chance is jury question).

[67] Shell & Bufkin, *supra* note 59, at 111.

[68] Note, *supra* note 57, at 498.

[69] 205 F.2d 61 (5th Cir. 1953).

[70] *Id.* at 63-64.

[71] *Id.* at 63.

[72] 235 F.2d 868 (5th Cir. 1956).

[73] *Id.* at 874 n.13. Based on the new evidence presented at the second trial, the Fifth

chance still exists.

The Fifth Circuit has further determined that the "conscious" last clear chance rule of the *Restatement (Second) of Torts*[74] is applicable in Mississippi.[75] Under this approach, a defendant must subjectively recognize a plaintiff's situation, realize the danger involved in it, and then use less than reasonable care in exercising his last clear chance to avoid the accident.[76] By negative implication, "unconscious" last clear chance—when a defendant should have known a plaintiff was in a position of inextricable peril even though the former did not actually so know[77]—has not survived comparative negligence in Mississippi.

The reasoning of the Fifth Circuit cases utilizing last clear chance may be supported by arguing that because the Mississippi Legislature did not specifically abolish the last clear chance doctrine, the legislature intended for it to continue to exist. The language of the comparative negligence statute, however, suggests the contrary; it provides that in all actions brought for personal injury or for injury to property, all questions of negligence and contributory negligence shall be for the jury to decide.[78] The form in which last clear chance now exists deprives the doctrine of its traditional strength. Because a trial court is directed to allow all questions of negligence to be decided by the jury, the defendant cannot be given a peremptory instruction that prevents the comparative negligence issue from reaching the jury.[79] It would seem then, despite the doctrine being retained in theory, that comparative negligence has supplanted last clear chance for all practical purposes.[80] Moreover, the general purpose of the comparative negligence statute is to allow damage apportionment on the basis of fault.[81] A broad last clear chance

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Circuit concluded that the trial court erred in not directing a verdict for the railroad company. *Id.* at 878.

[74] RESTATEMENT (SECOND) OF TORTS § 479 (1965).

[75] *See, e.g.*, Wright v. Standard Oil Co., 470 F.2d 1280, 1294 (5th Cir. 1972) (last clear chance doctrine not applied where truck driver failed to see minor child).

[76] *Id.*

[77] W. PROSSER, *supra* note 2, § 66, at 430.

[78] *See supra* text accompanying note 62.

[79] Note, *supra* note 57, at 499.

[80] *Id.* at 498-99.

[81] V. SCHWARTZ, *supra* note 21, § 7.2, at 137.

doctrine would defeat the purpose of the statute because the doctrine could reduce sharply the number of cases in which apportionment can be accomplished.[82]

Treating the last clear chance doctrine as a version of the "sole proximate cause" defense presents perhaps a plausible argument for its retention in a comparative fault system.[83] For example, when a defendant has the last clear chance to avoid an accident but negligently fails to utilize it, the defendant's actions can be found to be the sole proximate cause of the accident.[84] Such a finding would leave nothing to compare because there is no causal connection between the plaintiff's contributory negligence and his injury.[85]

On the other hand, one can view last clear chance as a fault doctrine,[86] which this writer believes to be the proper view. Under this view, a defendant is seen as more at fault than a plaintiff, and as a matter of policy, the defendant's fault should excuse that of the plaintiff.[87] Mississippi's comparative negligence statute abrogates the need for last clear chance if this view is followed.[88]

The last clear chance doctrine presents needless duplication in a system of comparative negligence because both doctrines attempt to evade the harsh effects of contributory negligence.[89] Because both doctrines serve the same purpose, only one should be applied in a particular case.[90] When a legislature sees fit, as did the Mississippi Legislature, to abolish contributory negligence as a complete defense, the need for last clear chance, particularly when viewed as a fault doctine, is obviated.[91]

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[82] *Id.*

[83] *See id.* (defendant had last opportunity to avoid and comparative negligence does not address proximate cause issue); *see infra* note 120.

[84] V. SCHWARTZ, *supra* note 21, § 7.2, at 137.

[85] *Id.* at 137-38.

[86] *Id.* at 138-39.

[87] *Id.* at 138.

[88] *See id.* at 139 (last clear chance doctrine not in harmony with comparative negligence statutes).

[89] Note, *Comparative Negligence and the "Jackass Doctrine" (Last Clear Chance)*, 6 S. DAK. L. REV. 96, 103-04 (1961).

[90] *Id.* at 104.

[91] *See* Note, *supra* note 57, at 498-99 (last clear chance doctrine not needed because questions of negligence and contributory negligence are for the jury).

In light of the *Underwood* decisions rendered by the Fifth Circuit Court of Appeals, either the Mississippi Legislature or the Mississippi Supreme Court should speak authoritatively concerning the retention or the abolition of the last clear chance doctrine. This writer urges abolition of the doctrine in Mississippi.

B. Assumption of Risk

Assumption of risk, like contributory negligence, is a defense in a negligence action that completely bars a plaintiff's recovery.[92] This doctrine has been the subject of much controversy, and the courts have used the term in several different senses.[93] For purposes of this article, discussion of this doctrine is limited to "express" and "implied" assumption of risk and is focused primarily upon the latter aspect of the doctrine. Express assumption of risk occurs when parties agree in advance that one of them is under no obligation to use reasonable care in a situation involving conduct that the law might otherwise deem negligent.[94] Implied assumption of risk applies when an individual knowingly and voluntarily encounters a risk, thus relieving another of any duty toward him.[95]

Although the Mississippi Legislature did not abolish the assumption of risk defense when it enacted its comparative negligence statute, the defense has been abrogated in some instances. Section 193 of the Mississippi Constitution abolished the defense as it applied to railroad employees.[96] In 1914, assumption of risk was eliminated as a defense in master-servant relationships, with two exceptions: "[1] conductors, or [2] locomotive engineers, in charge of dangerous or unsafe cars or engines vol-

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[92] W. PROSSER, *supra* note 2, § 68, at 439-40.

[93] *See* Keeton, *Assumption of Risk in Products Liability Cases*, 22 LA. L. REV. 122, 124-28 (1961) (assumption of risk has been classified as express, subjectively consensual, objectively consensual, by consent to conduct or condition, associational, and imposed).

[94] RESTATEMENT (SECOND) OF TORTS § 496B comment a (1965). Express assumption of risk may be general, whereby a defendant is relieved of all obligations to protect a plaintiff, or it may be limited to a specific risk. *Id.*

[95] V. SCHWARTZ, *supra* note 21, § 9.1, at 155.

[96] MISS. CONST. art. VII, § 193.

untarily operated by them."[97] Further, since the enactment of Mississippi's workers' compensation law in 1948, assumption of risk can no longer be asserted as a defense for employers in actions by employees entitled to coverage under that law.[98]

Express assumption of risk as a complete defense appears to remain unaltered by a comparative fault statute.[99] This is consistent with comparative fault principles, because parties are entering into a contractual relationship with each other to limit liability. On the other hand, the spirit of comparative fault apparently dictates that implied assumption of risk no longer be a defense.[100] In 1947, however, the Mississippi Supreme Court, in *Saxton v. Rose*,[101] determined that "[t]he common law doctrine of assumption of risk is in full force [in Mississippi] except as between master and servant."[102] In *Saxton*, the plaintiff's decedent was killed while riding in the cabin of the defendant's truck.[103] The driver of the defendant's truck was intoxicated at the time, and the decedent was fully aware of this fact.[104] The supreme court held that assumption of risk barred the plaintiff's recovery and distinguished assumption of risk from contributory negligence.[105] The *Saxton* opinion has been severely criticized.[106]

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[97] Act of Feb. 28, 1914, ch. 156, 1914 Miss. Laws 200 (codified at MISS. CODE ANN. § 11-7-19 (1972)).

[98] *Id.* § 71-3-9.

[99] V. SCHWARTZ, *supra* note 21, § 9.2, at 158-61.

[100] *See* Note, *supra* note 57, at 501 (spirit of defense indicates that it should properly be a jury question).

[101] 201 Miss. 814, 29 So. 2d 646 (1947).

[102] *Id.* at 823, 29 So. 2d at 649.

[103] *Id.* at 819, 29 So. 2d at 647.

[104] *Id.* at 820, 29 So. 2d at 647.

[105] In distinguishing these concepts, the court stated:

> "Assumption of risk," sometimes called "incurred risk," applies when a party voluntarily and knowingly places himself in such a position, or submits himself to such a condition, appreciating that injury to himself on account thereof is liable to occur at any and all times so long as such position or condition continues. Contributory negligence arises when, but not until, the injured person by his own conduct has done something, or has omitted to do something, which contributes to the particular event, and at the particular time and place, which was the immediate cause of the injury.

Id. at 823, 29 So.2d at 649.

[106] *See* Note, *supra* note 57, at 500-01 (*Saxton* holding is unjust in light of comparative negligence statute).

One commentator has asserted:

> The reasoning and result of [*Saxton*] . . . emphasize the injustice of allowing assumption of risk to continue as a complete bar to recovery after the adoption of a comparative negligence statute. Apparently the rule in Mississippi now is that one who sits passively while the defendant drives recklessly is completely barred from recovery because he has assumed the risk, while one who actively encourages the defendant's reckless conduct may be granted partial recovery because he is contributorily negligent. A more anomalous result could not be reached.[107]

The Mississippi Supreme Court has sought to diminish the adverse effects of assumption of risk. The court does not appear to allow this defense when a plaintiff has reasonably assumed a known risk.[108] For example, in *Ideal Cement Co. v. Killingsworth*,[109] an action by a widow and two minor children for the death of their decedent who was killed when struck by an automobile, the court held that the decedent was not guilty of assumption of risk where he had been pushing a stalled automobile across a highway intersection on a damp, dark night.[110] This result appears justified because it does not deny recovery to a plaintiff who reasonably encounters a known risk when the fault of the defendant is established.

Additionally, the issue of assumption of risk is now left to the jury. In *Elias v. New Laurel Radio Station, Inc.*,[111] the Mississippi Supreme Court held that if the question of assumption of risk arises in a case, it, like contributory negligence, should go to the jury.[112] *Elias* involved an action against the operator of a

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[107] Note, *Contributory Negligence and Assumption of Risk—The Case for Their Merger*, 56 MINN. L. REV. 47, 70-71 (1971).

[108] Implied reasonable assumption of risk occurs when a person knows of and appreciates a danger and decides to encounter it as an ordinarily prudent man would have done. *Restatement (Second) of Torts* §§ 496C-496E (1965). Implied unreasonable assumption of risk occurs when a person decides to confront a danger so great that no sensible person would have incurred it. *Id.* § 466.

[109] 198 So. 2d 248 (Miss. 1967).

[110] *Id.* at 249-50.

[111] 245 Miss. 170, 146 So. 2d 558 (1962).

[112] *Id.* at 180, 146 So. 2d at 562. The court gave no indication as to the type of jury instruction that would be appropriate. *Id.* at 184, 146 So. 2d at 564.

bowling alley for injuries sustained by a bowler who had slipped because the concourse of the bowling alley was wet.[113] In this case, a jury was allowed to apply its own standard of comparative negligence to circumvent the harshness of the assumption of risk defense.[114]

Braswell v. Economy Supply Co.,[115] is a useful illustration of the current status of the assumption of risk defense in Mississippi. In that case, the supreme court held that "where assumption of risk overlaps and coincides with contributory negligence the rules of the defense of contributory negligence shall apply."[116] Such a rule would seem totally unnecessary in view of the fact that assumption of risk has always been a special case, and thus a subset, of contributory negligence. This holding in *Braswell* would not be remarkable were it not for the fact that, while reviewing another case earlier in the opinion, the court stated that it was proper to use not only contributory negligence rules, but assumption of risk rules as well.[117] Furthermore, in addition to this one apparent incongruity, the court also pointedly announced in *Braswell* that the general rule that contributory negligence supplant assumption of risk does not affect a defense based upon the theory that a plaintiff can be the "sole proximate cause" of his own injuries.[118] It is difficult to render the *Braswell* opinion internally consistent, or to make sense of the emphasis upon, and juxtaposition of, the defenses of assumption of risk and sole proximate cause in that opinion.[119] One is forced

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[113] *Id.* at 173-74, 146 So. 2d at 559.

[114] *Id.* at 184, 146 So. 2d at 564.

[115] 281 So. 2d 669 (Miss. 1973).

[116] *Id.* at 677.

[117] *Id.* at 675. In reviewing Herod v. Grant, 262 So. 2d 781 (Miss. 1972), the *Braswell* court observed that "[t]he doctrine of assumption of risk was properly applied to the unusual facts of this case and it represents one of the rare instances where it is applicable." 281 So. 2d at 675.

[118] 281 So. 2d at 677-78. The "sole proximate cause" defense stands for the proposition that if the plaintiff's conduct is deemed to be the "sole proximate cause" of his injury, the plaintiff is barred from recovery. *See* Illinois C.R.R. v. Smith, 243 Miss. 766, 774, 140 So. 2d 856, 859 (1962) (plaintiff's failure to look or listen at railroad crossing sole proximate cause of his injury).

[119] Any attempt to dismiss the curious opinion in *Braswell* as an aberration is unsuccessful because the supreme court reiterated these same apparent incongruities in Singleton v. Wiley, 372 So. 2d 272, 275 (Miss. 1979).

to conclude that the court must not be using the terms "assumption of risk" and "sole proximate cause" in their normal and traditional senses.[120] Rather than speculate as to precisely what new meanings the court is assigning to these terms, it is more reasonable to simply recognize that the proper employment of any of these defenses should not lead to results different from those obtained by comparative negligence rules.[121]

Like the last clear chance doctrine, retention of assumption of risk seems justified because the Mississippi Legislature did not abolish assumption of risk when it enacted the comparative negligence statute. This line of reasoning is convincing because the state legislature has abolished the defense in other instances.[122] Because assumption of risk is a judicially created doctrine, however, legislative intent on this matter should have been affirmatively expressed. Therefore, because there was no express legislative intent, it is within the province of the courts to abolish assumption of risk. Perhaps the reason for the lack of any such judicial activism is to be found, in part, in the fact that the strength of the assumption of risk defense has been largely vitiated by the statute declaring all determinations regarding negligence to be jury questions.

In Mississippi, if assumption of risk bars recovery only when the conduct of the plaintiff is unreasonable, it has no meaning independent of contributory negligence.[123] When a plaintiff unreasonably assumes a known risk, his fault in that regard is negligence, and his claim should be subject to apportionment under the comparative negligence statute. The *Restatement (Second) of Torts* supports this position:

> There are statutes which make contributory negligence only a partial defense, with the effect of reducing the recoverable damages, which have been construed to leave assumption of risk as a complete defense. It would appear that, unless such construction is clearly called for, it defeats the intent of the

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[120] *See* V. SCHWARTZ, *supra* note 21, § 4.4, at 91-92; *supra* text accompanying notes 116-17.

[121] *See infra* text accompanying notes 123-24.

[122] *See supra* text accompanying notes 96-98.

[123] For a general discussion of the relationship of assumption of risk to contributory negligence, see Note, *supra* note 107, at 72.

> statute in any case where the same conduct constitutes both contributory negligence and assumption of risk, since the purpose of the act would appear to be to reduce the damages in the case of all such negligent conduct, whatever the defense may be called . . . .[124]

Unreasonable assumption of risk is simply analogous to contributory negligence. Even if there is some distinction, our law makes no such reasonable/unreasonable distinction regarding a defendant's conduct.[125] For example, in a situation in which a motorist runs a traffic light and causes an accident, it makes no difference whether he was simply careless or decided to take a chance because he was in a hurry. No such distinction should be made regarding a plaintiff's conduct either, especially in a comparative fault jurisdiction. Therefore, Mississippi should alter its position regarding assumption of risk and abolish the doctrine as a matter of law.

C. Effect on Multiple Parties

1. Contribution

A Mississippi statute provides for contribution between or among joint tortfeasors when judgment has been rendered against them:

> In any action for damages where judgment is rendered against two (2) or more defendants, jointly and severally, as joint tortfeasors, the defendants against whom such a judgment is rendered shall share equally the obligation imposed by such judgment, and if one (1) of such defendants pays an amount greater than the total sum of the judgment divided by the number of defendants against whom the judgment was rendered, then the other defendants shall be jointly and severally liable to him for the amount so paid in excess of his proportionate part; provided that no defendant shall be liable to any other defendant for more than his proportionate share of the original judgment.

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[124] RESTATEMENT (SECOND) OF TORTS § 496A comment d (1965).

[125] *See* Wade, *Some Recent Changes in The Law of Torts*, 38 MISS. L.J. 565, 572 (1967) (comparative negligence should apply to situations involving assumption of risk when action by a party is analogous to contributory negligence).

. . . .

Provided further, that the liability of such defendants against whom such a judgment has been rendered shall be joint and several as to the plaintiff in whose favor such judgment has been rendered.[126]

Comparative fault is applicable between a plaintiff and multiple defendants, with the plaintiff's damages being reduced according to his degree of blame.[127] Each defendant remains severally liable to the plaintiff for the entire award, however, and contribution between or among joint tortfeasors is on a pro rata basis, rather than on proportionate fault.[128] For example, in an action in which a plaintiff was 30% at fault with two defendants 70% at fault, a defendant who pays the 70% has a right to recover from the other defendant his contribution of 35%.

While the pro rata, or equal division rule, is easily applied, it is not consonant with the Mississippi comparative negligence statute's goal of apportioning damages according to fault. Contribution should be determined in proportion to the negligence or fault of each defendant. Mississippi already has embraced "pure" comparative fault, and it would be fair to joint tortfeasors if that standard were extended to contribution.[129] This writer urges Mississippi to adopt a contribution provision simi-

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[126] MISS. CODE ANN. § 85-5-5 (1972). Section 85-5-5, Mississippi's version of the UNIFORM CONTRIBUTION AMONG JOINT TORTFEASORS ACT § 2(a) (1955), is poorly drafted. In addition to the fact that the statute uses "proportionate" language when it is a pro rata statute, it fails to mention what happens when a plaintiff does not sue all the joint tortfeasors. Professor Wade has contended that the statute applys only to the tortfeasors against whom a judgment has been rendered. Consequently, a plaintiff can prevent the operation of the statute by choosing to sue only one of the parties. Wade, *supra* note 125, at 574.

[127] *See supra* notes 57-62 and accompanying text.

[128] Some comparative fault jurisdictions have abolished joint and several liability. *See, e.g.*, KAN. STAT. ANN. § 60-258a (1964) (judge must approve form of judgment at time of entry of judgment); N.H. REV. STAT. ANN. § 507:7-a (Supp. 1979) (each defendant is liable for his proportionate amount of damages). Mississippi has taken the correct approach by retaining joint and several liability. Contribution between or among joint tortfeasors, however, should be on a proportionate, rather than pro rata, basis. Both comparative fault and contribution can function in a single jurisdiction without any inherent conflict between them.

[129] Some commentators have argued that allowing comparison of fault between opposing parties to a lawsuit but not between or among joint tortfeasors is a denial of equal protection. Sowle & Conkle, *supra* note 2, 1083, 1124-33.

lar to that of the *Uniform Comparative Fault Act*,[130] which provides:

> (a) A right of contribution exists between or among two or more persons who are jointly and severally liable upon the same indivisible claim for the same injury, death, or harm whether or not judgment has been recovered against all or any of them. It may be enforced either in the original action or by a separate action brought for that purpose. The basis for contribution is each person's equitable share of the obligation, including the equitable share of a claimant at fault, as determined in accordance with the [comparative fault] provisions of Section 2.[131]

2. Indemnity

Indemnity shifts the loss from one tortfeasor who has been compelled to pay the loss to another who is required to bear the entire loss.[132] The common law imposed a duty of indemnification upon an active tortfeasor when contribution was not allowed between joint tortfeasors.[133] In a successful indemnity action, as distinguished from a contribution action, a plaintiff indemnitee recovers his entire loss from a defendant indemnitor.[134]

Mississippi recognizes a right of indemnity when one

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[130] UNIF. COMPARATIVE FAULT ACT § 4, 12 U.L.A. 33 (Supp. 1982).

[131] *Id.* at 40.

[132] W. PROSSER, *supra* note 2, § 51, at 310.

[133] V. SCHWARTZ, *supra* note 29, § 16.9, at 272. Traditionally, indemnity has been granted in the following situations:

1. Where the indemnitee has only an imputed or vicarious liability for damage caused by the indemnitor.
2. Where the indemnitee has incurred tort liability by performing, at the direction of and in reliance upon the indemnitor, an act not manifestly wrong.
3. Where the indemnitee has incurred liability for failure to correct a hazardous condition which, as between the indemnitor and the indemnitee, it was the duty of the indemnitor to correct.
4. Where the indemnitee has incurred liability by reason of his reliance, even negligent reliance, upon the duty of care which the indemnitor owes as a supplier of goods.

Annot., 88 A.L.R. 2D 1355, 1356-57 (1963).

[134] Symons v. Mueller Co., 526 F.2d 13, 16 (10th Cir. 1975); W. PROSSER, *supra* note 2, § 51; V. SCHWARTZ, *supra* note 21, § 16.9, at 271.

tortfeasor's fault was active and the other's was passive.[135] Two prerequisites must be met before indemnification is allowed in Mississippi: (1) the damages that the plaintiff seeks to shift must have been imposed upon him as a result of a legal obligation owed to a third party, and (2) the plaintiff could not have actively participated in the wrong.[136]

When the party seeking indemnification has not actively participated in the wrong doing, the same result is obtained through either the concept of indemnity or the logic of comparative negligence.[137] When the party seeking indemnification has not been wholly passive, yet is not solely responsible for the injury, the doctrine of contribution has achieved results consonant with the aims of comparative negligence.[138] The policy manifested in comparative negligence seems to favor contribution between tortfeasors over common law indemnity except when a tortfeasor takes a passive role and the results of both doctrines coincide.[139] This is logical because comparing fault in indemnity cases amounts to nothing more than applying a modified form of contribution. With such options available, the need disappears for a separate indemnity doctrine to deal with situations in which one party has been wholly passive.[140]

D. Intentional Tort

In 1978, the Mississippi Supreme Court extended comparative fault concepts to an intentional tort case. In *Comer v. Greg-*

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[135] *See, e.g.*, Celotex Corp. v. Becknell Constr., Inc., 325 So. 2d 566, 568 (Miss. 1976) (prime contractor indemnified by subcontractor for defect in airport roof); Bush v. City of Laurel, 215 So. 2d 256, 259-60 (Miss. 1968) (municipality indemnified when contractor failed to maintain streets).

[136] Home Ins. Co. of N.Y. v. Atlas Tank Mfg., 230 So. 2d 549, 551 (Miss. 1970).

[137] *See* V. SCHWARTZ, *supra* note 21, § 16.9, at 272. There are few cases in Mississippi concerning indemnity.

[138] *Id. But cf.* St. Louis-San Francisco Ry. v. United States, 187 F.2d 925, 927 (5th Cir. 1951) (in Mississippi, as against an active wrongdoer, a right of indemnity favors one not actively at fault); Home Ins. Co. of N.Y. v. Atlas Tank Mfg., 230 So. 2d 549, 551 (Miss. 1970) (joint tortfeasor whose liability is secondary and based on passive negligence may be able to shift responsibility to other joint tortfeasor when equitable).

[139] V. SCHWARTZ, *supra* note 21, § 16.9, at 273. Recent decisons have limited common law indemnity in states recognizing comparative negligence. *Id.* § 16.9, at 135-38 (Supp. 1981).

[140] *Id.* § 16.9, at 272-74 (1974).

ory,[141] the plaintiff, a trespasser, was shot by the defendant landowner who thought the plaintiff was reaching for a gun in his coveralls.[142] The plaintiff sued the defendant for assault and battery, and the jury returned a verdict of $9,000 for the plaintiff.[143] On the plaintiff's motion, the trial court granted a $5,500 additur, which the defendant rejected. Based upon the defendant's rejection, a second trial was held, and the jury returned a verdict of $125 for the plaintiff.[144] On appeal by both parties, the Mississippi Supreme Court affirmed the reduction,[145] basing its holding on section 11-7-61 of the Mississippi Code, which provides, "In actions for libel or slander, assault and battery, and false imprisonment, the defendant, under the plea of not guilty, may give in evidence any mitigating circumstances to reduce the damages notwithstanding he may also have pleaded a justification."[146] According to the court, the mitigating circumstances in *Comer* included the trespass late at night, the disregard of the posted signs, the dropping of a nearly empty rum bottle by one of the trespassers, the intoxicated appearance of the trespassers, and, most importantly, the plaintiff's reaching into his coveralls.[147] Furthermore, the court stated that "mitigating circumstances are closely akin to contributory negligence"[148] and cited section 11-7-17 of the Mississippi Code, which requires that "[a]ll questions of negligence and contributory negligence shall be for the jury to determine."[149] The court upheld the small jury verdict based upon the effect of these mitigating circumstances, despite the fact that no jury instructions were requested regarding how such mitigating factors should be

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[141] 365 So. 2d 1212 (Miss. 1978).

[142] *Id.* at 1213.

[143] *Id.*

[144] *Id.*

[145] *Id.*

[146] MISS. CODE ANN. § 11-7-61 (1972).

[147] 365 So. 2d at 1213.

[148] *Id.* The court's determination that mitigating circumstances and contributory negligence are closely related could be extended to libel and slander and to false imprisonment, which are included in MISS. CODE ANN. § 11-7-61 (1972). *See* Note, *Comparative Fault and Intentional Torts*, 12 LOY. L.A.L. REV. 179, 190-91 (1978) (denying recovery for unjustifiable reliance in a misrepresentation suit is analogous to denying recovery due to contributory negligence).

[149] MISS. CODE ANN. § 11-7-17 (1972).

weighed or considered.[150]

Through the consideration of mitigating factors, the *Comer* court reached a result that seems consistent with "pure" comparative fault principles. As one commentator has observed: "By extending comparative fault to include intentional torts, the courts would not only retain consistency in the development of comparative fault but would also obviate the inequities which result from restricting the definition of 'fault' to 'negligent fault.' "[151] The extension of comparative fault to include intentional torts appears to be just, because in cases such as *Comer*, both parties can be at fault. This extension is also consistent with prior practice in Mississippi because apportioning liability according to relative fault among all parties has been applied in negligence and strict liability cases.[152]

E. Gross Negligence and Reckless Misconduct

Reckless or grossly negligent misconduct, which is closely akin to an intentional tort, is subject to comparison under Mississippi's comparative negligence statute.[153] A plaintiff's award may still be reduced despite such extreme wrongdoing.[154] Soon after the enactment of the comparative negligence statute in 1910, the Mississippi Supreme Court stated:

> This statute is plain, unambiguous, and easily construed. Prior to its passage contributory negligence—any contributory negligence, slight, ordinary, or gross, if negligence can in fact be so

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[150] 365 So. 2d at 1214-15; *cf.* Alton v. Wood, 298 So. 2d 700, 702 (Miss. 1974) (jury may consider plaintiff's contributory negligence although not pleaded and not instructed); Carr v. Cox, 255 So. 2d 317, 318 (Miss. 1971) (same).

[151] Note, *supra* note 148, at 191.

[152] *See infra* text accompanying notes 166-77.

[153] Yazoo & M.V.R.R. v. Carroll, 103 Miss. 830, 835, 60 So. 1013, 1014 (1913). Because the Mississippi Supreme Court does not distinguish between different forms of negligence, the court applies the same law to the different forms. *See* Planter Wholesale Grocery v. Kincade, 210 Miss. 712, 722-23, 50 So. 2d 578, 584 (1951); Fuller v. Illinois C.R.R., 100 Miss. 705, 716, 56 So. 783, 785 (1911). This being the case, it may be inferred that recklessness is also subject to comparison. *See also* Note, *supra* note 57, at 504-05 (because comparative negligence standards apply to gross negligence, they ought also to apply to, and thus eviscerate, the sole proximate cause defense).

[154] *See* Anderson v. Eagle Motor Lines, 423 F.2d 81, 83 (5th Cir. 1970) (applying Mississippi law).

> classified—barred a recovery, and the manifest legislative purpose in enacting it was simply to alter the rule on this subject, which had been established by the courts, so that such negligence should not thereafter bar recovery, but should simply cause a diminution of the amount thereof. This statute does not deal with, and was not intended to introduce into our jurisprudence, degrees of contributory negligence, but it deals with contributory negligence proper of every character.[155]

Because Mississippi is a "pure" comparative negligence jurisdiction, greater or lesser negligence on the part of a defendant has no effect other than to alter a plaintiff's recovery.[156] Likewise, a plaintiff's negligence, no matter how aggravated, must be compared to that of a defendant.[157] Mississippi courts only distinguish between the degrees of negligence of parties to a suit in order to determine apportionment of fault.[158]

F. Products Liability

There are presently three separate tort actions for recovery by an injured consumer against a supplier of a product: (1) negligence, (2) breach of warranty, and (3) strict liability.[159] Since the enactment of the Mississippi comparative negligence statute, there is no question that the doctrine of comparative fault applies in products liability cases based on negligence. This discussion, therefore, examines only the effect of comparative fault in products liability cases based upon the breach of an implied warranty or upon strict liability.

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[155] Yazoo & M.V.R.R. v. Carroll, 103 Miss. 830, 835, 60 So. 1013, 1014 (1913).

[156] For the text of the comparative negligence statute, see *supra* text accompanying note 61.

[157] *See* Salster v. Singer Sewing Mach. Co., 361 F. Supp. 1056, 1060 (N.D. Miss. 1973); Cothern v. Brewer, 234 Miss. 676, 684, 107 So. 2d 361, 365 (1958); *see also* MISSISSIPPI MODEL JURY INSTRUCTIONS, *Negligence* § 26.02 (reduce damages in proportion to plaintiff's negligence).

[158] *See* Moore v. Abdalla, 197 Miss. 125, 130, 19 So. 2d 502, 503-04 (1944) (jury to assess damages in proportion to parties' negligence).

[159] Wade, *On the Nature of Strict Liability for Products*, 44 MISS. L.J. 825, 849 (1973).

1. Breach of Implied Warranty

In 1952, in *Missouri Bag Co. v. Chemical Delinting Co.*,[160] the Mississippi Supreme Court applied comparative fault principles to a situation in which the plaintiff brought an action against the defendant to recover the balance allegedly due to the plaintiff for the purchase price of bags sold by the plaintiff to the defendant. The defendant sought recoupment and offset because of alleged defects in prior shipments of bags for which the defendant had made payment. The trial court held for the defendant.[161] The supreme court reversed and remanded the case because the trial court did not instruct the jury to "take into account the negligence of the defendant in using the bags after the defendant had discovered that the bags were defective."[162] This instruction should have been given to help the jury determine damages consistent with "pure" comparative fault and the Mississippi comparative negligence statute.[163] The phrase in the comparative negligence statute that "all actions hereafter brought for personal injuries . . . death, or for injury to property"[164] is susceptible to very broad interpretation.[165]

2. Strict Liability

Under the strict liability in tort theory, a defendant may be held liable in some cases even though he may have exercised reasonable care in his actions.[166] Mississippi adopted the strict liability in tort theory in products liability cases in *State Stove*

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[160] 214 Miss. 13, 58 So. 2d 71 (1952).

[161] *Id.* at 23, 58 So. 2d at 73.

[162] *Id.* at 33, 58 So. 2d at 78.

[163] *Id.*, 58 So. 2d at 78.

[164] MISS. CODE ANN. § 11-7-15 (1972).

[165] Actions based upon implied warranty did not develop from the tort of deceit, but rather from contract law. Traditionally, contributory negligence would not be applicable to a cause of action grounded in contract law. It is, therefore, arguable whether the comparative negligence statute, at the time it was enacted, was intended to cover actions based on implied warranty. *See, e.g.*, Wilson v. B.F. Goodrich Co., 52 Or. App. 139, 627 P.2d 1280, 1287 (1981). *But see* Daly v. General Motors Corp., 20 Cal. 725, 575 P.2d 1162, 1165-68, 144 Cal. Rptr. 380, 383-86 (1978). *See generally* P. RHEINGOLD & S. BIRNBAUM, PRODUCTS LIABILITY: LAW, PRACTICE, SCIENCE 369 (2d ed. 1975).

[166] *See* W. PROSSER, *supra* note 2, § 75.

Manufacturing v. Hodges.[167] A plaintiff who initiates a suit under strict products liability, however, may be barred from recovery if he has misused the product,[168] has been contributorily negligent,[169] or has failed to discover or foresee dangers that an ordinary person would, or should, have discovered.[170]

Acts involving the misuse of a product are generally classified into two categories: (1) foreseeable misuse[171] and (2) unforeseeable misuse.[172] In Mississippi, when a defendant should have foreseen a certain misuse of a product, misuse is not a defense to a strict products liability claim. In 1974, in *Early-Gary, Inc. v. Walters*,[173] a personal injury case, a restaurant patron sued the restaurant owner and the ketchup manufacturer under a strict products liability theory when the bottle of ketchup he was attempting to open broke as he struck the bottom of the bottle with his hand.[174] In affirming the lower court's decision awarding damages to the plaintiff,[175] the Mississippi Supreme Court, utilizing the standard adopted in *State Stove Manufacturing v. Hodges*,[176] held that the restaurant owner and the ketchup man-

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[167] 189 So. 2d 113, 118 (1966).

[168] *See, e.g.*, Harville v. Anchor-Waste Co., 663 F.2d 598, 605 (5th Cir. 1981); Sanchez v. Black Bros. Co., 98 Ill. App. 3d 264, 423 N.E.2d 1309, 1314 (1981); Early-Gary, Inc. v. Walters, 294 So. 2d 181, 186-87 (Miss. 1974); Wilson v. B.F. Goodrich Co., 52 Or. App. 139, 627 P.2d 1280, 1287 (1981).

[169] *See, e.g.*, Caterpillar Tractor Co. v. Ford, 406 So. 2d 854, 858 (Ala. 1981); Forrest City Mach. Works, Inc. v. Aderhold, 273 Ark. 33, 616 S.W.2d 720, 726 (1981); Dorry v. Lafluer, 399 So. 2d 559, 561 (La. 1981).

[170] *See, e.g.*, Haines v. Powermatic Houdaille, Inc., 661 F.2d 94, 96 (8th Cir. 1981); Alford v. Pool Offshore Co., 661 F.2d 43, 45 (5th Cir. 1981); Stephenson v. Dreis & Krump Mfg., 101 Ill. App. 3d 380, 428 N.E.2d 190, 194-95 (1981).

[171] *See* Polelle, *The Foreseeability Concept and Strict Products Liability: The Odd Couple of Tort Law*, 8 RUT.-CAM. L. REV. 101, 133-34 (1976) (foreseeable misuse of a product is use that a retailer/manufacturer knew or should have known a consumer would use it for). *See generally* Noel, *Defective Products: Abnormal Use, Contributory Negligence, and Assumption of Risk*, 25 VAND. L. REV. 93, 94 (1972).

[172] *See* Noel, *supra* note 171, at 95-105. The weight of modern authority does not require that the misuse, in fact and in actuality, be foreseen. Rather, it is sufficient that the misuse be, in theory, reasonably foreseeable. *Id.*

[173] 294 So. 2d 181 (Miss. 1974).

[174] *Id.* at 183.

[175] *Id.* at 185.

[176] In *State Stove* the court stated:

> [W]e conclude that the appropriate standards of responsibility are well stated in section 402A of the American Law Institute's Restatement of Torts (Sec-

ufacturer were strictly liable because the plaintiff had not misused the product, or, if he had, the misuse was foreseeable.[177] The court's reasoning implies that an unforeseeable misuse of a product can be a defense to a strict products liability action and that such a result is consistent with section 402A of the *Restatement (Second) of Torts*.[178]

Unreasonable assumption of risk remains a viable defense to strict products liability actions in Mississippi. In 1979, in *Alley v. Praschak Machine Co.*,[179] the Mississippi Supreme Court held that a jury instruction in a products liability case concerning the defense of assumption of risk was proper because the plaintiff was an experienced electrician and was aware of the danger of his activity.[180]

It is arguable that unreasonable assumption of risk is nothing more than a form of contributory negligence,[181] and, as such, it should be subject to fault apportionment under the Mississippi comparative negligence statute.[182] When a seller or manu-

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ond), which we adopt insofar as it applies to a manufacturer . . . . It states:

> (1) One who sells any product in a defective condition unreasonably dangerous to the user or consumer or to his property is subject to liability for physical harm thereby caused to the ultimate user or consumer, or to his property, if
>
> (a) the seller is engaged in the business of selling such a product, and
>
> (b) it is expected to and does reach the user or consumer without substantial change in the condition in which it is sold.
>
> (2) The rule stated in Subsection (1) applies although
>
> (a) the seller has exercised all possible care in the preparation and sale of his product, and
>
> (b) the user or consumer has not bought the product from or entered into any contractual relation with the seller.

189 So. 2d at 118.

[177] 294 So. 2d at 187.

[178] RESTATEMENT (SECOND) OF TORTS § 402A comment n (1965) provides, "If the user or consumer discovers the defect and is aware of the danger, and nevertheless proceeds unreasonably to make use of the product and is injured by it, he is barred from recovery." *Id.* at 356. Some courts have taken the position that there is no "defect" in the product when unforeseeable misuse occurs. *See, e.g.*, Eschback v. W.T. Grant's & Co., 481 F.2d 940, 943 (3rd Cir. 1973); Kaczmarek v. Mesta Mach. Co., 463 F.2d 675, 678-79 (3rd Cir. 1972).

[179] 366 So. 2d 661 (Miss. 1979).

[180] *Id.* at 665.

[181] W. PROSSER, *supra* note 2, § 65, at 424-25.

[182] *See* Buford v. Horne, 300 So. 2d 913, 916 (Miss. 1974).

facturer places a defective product on the market, sound principles of risk distribution place at least some of the financial responsibility of an accident upon the seller or manufacturer, even though the injured consumer of the product may have assumed the risk.[183]

While the Mississippi Supreme Court has not squarely faced the issue of whether contributory negligence in the form of foreseeable misuse will reduce a plaintiff's recovery in a strict products liability action; the court has, however, determined that such negligence cannot be a complete defense to a strict products liability action.[184] In 1975, in *Edwards v. Sears, Roebuck & Co.*,[185] the Fifth Circuit Court of Appeals interpreted the Mississippi comparative negligence statute[186] and held that the comparative fault requirements of the statute apply to strict liability actions, as well as to negligence actions.[187]

The Mississippi Supreme Court should accept the rationale of the Fifth Circuit because if a manufacturer or seller of a defective product is to be held financially responsible for the forseeable misuse of the product and the resulting injuries, it seems appropriate that a plaintiff/consumer who is also responsible for the foreseeable misuse of the product, and who seeks recovery under strict products liability, should have his recovery reduced by a percentage reflective of his fault in causing the injury.[188]

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[183] V. SCHWARTZ, *supra* note 21, § 12.5, at 201-06.

[184] *See* Ford Motor Co. v. Matthews, 291 So. 2d 169, 175 (Miss. 1974); *see also* Mobile & O.R.R. v. Campbell, 114 Miss. 803, 829, 75 So. 554, 557 (1917) (contributory negligence no defense when statute imposed strict liability on railroad). Other jurisdictions considering this question have generally held that contributory negligence may be a defense in strict liability cases. *See* West v. Caterpillar Tractor Co., 336 So. 2d 80, 92 (Fla. 1976) (contributory negligence is a defense to strict liability when not based on failure to discover defect or guard against possibility of its existence); Dippel v. Sciano, 37 Wis. 2d 443, 155 N.W.2d 55, 63-64 (1967) (contributory negligence a defense to strict liability). *But see* Kinard v. Coats Co., 37 Colo. App. 555, 553 P.2d 835, 837 (1976) (comparative negligence has no application to products liability cases; unforeseeable misuse is a defense).

[185] 512 F.2d 276 (5th Cir. 1975).

[186] *Id.* at 290.

[187] *Id.*

[188] *Cf., e.g.*, Buford v. Horne, 300 So. 2d 913, 916 (Miss. 1974) (comparative negligence requires only diminution of plaintiff's award when evidence shows plaintiff was contributorily negligent); Netzel v. State Sand & Gravel Co., 51 Wis. 2d 1, 186 N.W.2d 258, 264-65 (1971) (same). *See generally* V. SCHWARTZ, *supra* note 21, § 12.4, at 200.

G. Conflict of Laws

For purposes of tort law, the four major choice of law rules in the United States are the lex loci delicti approach,[189] the Currie approach,[190] the *Restatement (Second)* approach,[191] and the Leflar approach.[192] The traditional choice of law rule is the lex loci delicti approach, which requires that the law of the place where the wrong occurred control the substantive rights of the parties.[193] For example, if a party is injured in a state that recognizes contributory negligence and that follows the lex loci delicti approach, but he sues in a state that has adopted comparative negligence, the law of the former state governs the parties' substantive rights.[194] The Currie approach emphasizes the governmental interests and concerns of the competing jurisdictions.[195] Under the *Restatement (Second)* approach, a trial court applies the law of the state that has "the most significant relationship" with the parties and determines the parties' substantive rights and liabilities accordingly.[196]

To resolve conflict of laws disputes, the Leflar approach in-

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[189] *See* RESTATEMENT OF CONFLICT OF LAWS § 377 (1934). The lex loci delicti approach is also referred to as the Beale approach, reflecting the importance of Harvard University Professor Joseph H. Beale, the Reporter for the first *Restatement*. *See* H. WOODS, *supra* note 27, § 15:1, at 338 (noting dominance of Beale's "purely mechanical" approach to conflicts questions).

[190] *See* B. CURRIE, SELECTED ESSAYS ON THE CONFLICT OF LAWS (1963).

[191] *See* RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 145(1) (1971).

[192] *See* Leflar, *Choice Influencing Considerations in Conflict of Laws*, 41 N.Y.U. L. REV. 267 (1966); see *infra* notes 197-202.

[193] RESTATEMENT OF CONFLICT OF LAWS § 377 (1934).

[194] H. WOODS, *supra* note 27, § 15:5, at 337-38 (citing Powell Bros. Truck Lines v. Barnett, 194 Ark. 769, 109 S.W.2d 673, 674 (1937)).

[195] CURRIE, *supra* note 190, at 183-84; *see also* Reich v. Purcell, 67 Cal. 2d 551, 432 P.2d 727, 730-31, 63 Cal. Rptr. 31, 34-35 (1967) (in wrongful death action tried in California, Ohio's interests, in affording full recovery to Ohio plaintiff injured in collision with Missouri defendant, outweighed Missouri's statutory policy of limiting damages to a fixed amount).

[196] RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 145(1) (1971). Section 145 sets forth the significant contacts that are considered in determining which state's law should apply. Each of the contacts listed in § 145 must be assigned a relative degree of importance with respect to the specific issue under consideration. In determining the importance of these contacts, the factors enumerated in § 6 of the *Restatement (Second)* must be evaluated. Sabell v. Pacific Intermountain Express Co., 76 Colo. App. 60, 536 P.2d 1160, 1163-64 (1975). Mississippi has apparently adopted the *Restatement (Second)* approach. *See infra* notes 203-12 and accompanying text.

corporates "choice-influencing considerations,"[197] which have been variously grouped under five general headings: (1) predictability of results,[198] (2) maintenance of interstate and international order,[199] (3) simplification of the judicial task,[200] (4) advancement of the forum's governmental interests,[201] and (5) application of the better rule of law.[202]

In 1968, in *Mitchell v. Craft*,[203] the Mississippi Supreme Court refused to apply the traditional rule of lex loci delicti to resolve a conflict of laws dispute.[204] Instead, the court discussed favorably the two modern approaches, Leflar and *Restatement (Second)*,[205] and, apparently, adopted the latter.[206]

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[197] Leflar, *supra* note 192, at 279.

[198] *Id.* at 282-85.

[199] *Id.* at 285-88.

[200] *Id.* at 288-90.

[201] *Id.* at 290-95.

[202] *Id.* at 295-304.

[203] 211 So. 2d 509 (Miss. 1968).

[204] *Id.* at 512-13. The court stated, "The traditional rule, that the governing law is the law of the place where the injury occurred, has been discarded as a rule of invariable application in recent years by most of the courts which have examined it." *Id.* at 512 (footnote omitted).

[205] *Id.* at 514-16.

[206] *Id.* at 510, 515-16. The court's decision is somewhat confusing on this point, because the Leflar approach was also discussed extensively and used to analyze the facts in *Mitchell*. *Id.* at 514. Indeed, *Mitchell* has been cited as Mississippi's acceptance of the Leflar approach. H. WOODS, *supra* note 27, § 15:4, at 340. The Mississippi Supreme Court, however, expressly stated in *Mitchell* that the *Restatement (Second)* "summarizes the rules which we think are applicable to this case." 211 So. 2d at 515. Subsequent decisions indicate that the supreme court relies on the Leflar factors as a helpful list to assist in determining which state has the greater substantial relationship, but, in the end, seems to apply the *Restatement (Second)* approach. *See* Wright v. Standard Oil Co., 470 F.2d 1280, 1284-86 (5th Cir. 1972); *see also* Fells v. Bowman, 274 So. 2d 109, 113 (Miss. 1973) (Louisiana, although situs of accident, had no legitimate concern regarding application of Mississippi's comparative negligence statute).

Two commentators have concluded that Mississippi is among the states that have rejected the traditional conflicts approach in favor of "choice of law analyses, considering the various governmental interests or significant contacts each jurisdiction has with the conduct causing the injury." C.R. HEFT & C.J. HEFT, *supra* note 56, § 1.360, at 13 & 14 n.6 (Supp. 1982).

Professor Leflar has aptly summarized the state courts' adoption of various conflicts theories:

> [I]t appears that the various scholarly views concerning choice of law, developed during the last couple of decades, are being accepted by courts as though they constituted one somewhat multi-faceted approach to the subject. Essen-

Mitchell involved an action between two personal representatives of Mississippi decedents killed in an automobile accident in Louisiana, a contributory negligence state.[207] The court reasoned that because both decedents were domiciled in Mississippi and were traveling to their homes when the accident occurred,[208] and because their estates were being administered in Mississippi,[209] and because the rule of lex loci delicti relied on a "purely adventitious" relationship between the accident and Louisiana,[210] "the rights and liabilities of the parties should be determined by the law of Mississippi, which has the most substantial relationship to the parties."[211]

The adoption of this modern conflict of laws theory helps keep Mississippi a "pure" comparative fault state. Under this approach, a court usually can find justification for not applying contributory negligence in choice of law situations.[212]

Conclusion

Mississippi took a major step in tort law when it passed a "pure" comparative negligence statute in 1910. The state has gone even further by not limiting the application of comparative fault solely to actions based on negligence. The extension of comparative fault to actions for intentional tort, for example, is

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> tially they are consistent with each other. Any one of them is likely to produce about the same result on a given set of facts as will another.
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> . . . .
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> The point to be emphasized is that the modern decisions, regardless of exact language, are substantially consistent with each other. Whether the opinion language is that of *Restatement (Second)* most significant relationship, or of Brainerd Currie's governmental interest analysis, or of the five choice-influencing considerations . . . the real reasons and the results are likely to be about the same.

R. Leflar, American Conflicts Law § 109, at 219 (1977).

[207] 211 So. 2d at 510, 512.

[208] *Id.* at 510, 513.

[209] *Id.*

[210] *Id.*

[211] *Id.* at 516.

[212] *See* Fells v. Bowman, 274 So. 2d 109, 113 (Miss. 1973) (when all parties to suit lived in Mississippi and all vehicles were owned by Mississippians, Louisiana, although the place of the accident, had no legitimate concern in not having Mississippi's comparative negligence statute applied).

consistent with modern comparative fault principles. Retention of common law defenses such as last clear chance and assumption of risk, however, has served only to muddy the water of "pure" comparative fault in Mississippi. Elimination of these common law defenses would help purify those waters and would place Mississippi, once again, at the forefront of states that justly apportion damages on the basis of fault.

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COMMENT

INSTALLMENT REPORTING AND THE IMPACT OF THE 1980 REVISION ACT

Introduction

The general rule for computing gain on the sale or other disposition of property is the excess of the amount realized over the adjusted basis of the property; the general rule for loss is the excess of the adjusted basis over the amount realized.[1] "Amount realized" is the sum of any money plus the fair market value of all other property received by the seller.[2] Further, unless otherwise provided by the Internal Revenue Code, the entire amount of gain or loss shall be recognized[3] and, ordinarily, any gain is taxed in the year of sale.[4] Some sales, however, are structured so that part or all of the sales price is paid after the close of the taxable year of the sale. These sales are called deferred payment sales and typically fall into one of two categories:[5] one category includes sales for which gain may be recognized on the installment method,[6] and the other category encompasses the entire class of transactions for which installment reporting is not available or is not used.[7]

The installment method of reporting was enacted as a relief provision to permit the spreading of income taxation over the periods during which payments are actually received.[8] Basically,

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[1] I.R.C. § 1001(a) (1976).

[2] *Id.* § 1001(b).

[3] *Id.* § 1001(c).

[4] 2 J. Mertens, The Law of Federal Income Taxation § 15.01 (rev. ed. 1974).

[5] I.R.S., U.S. Dep't of Treasury, Pub. No. 334, Tax Guide for the Small Business 78 (rev. ed. 1981).

[6] I.R.C. § 453 (West Supp. 1981).

[7] *See infra* notes 252-60 and accompanying text.

[8] The basic concept that installment sales should be separately treated for income

the installment method authorizes income recognition based on the same proportion of installment payments received in the current year that the gross profit realized bears to the total contract price.[9] Each dollar collected is deemed to contain a pro rata recovery of basis and profits. The installment method is not applicable to losses;[10] therefore, a loss sustained on an installment sale is deductible in the year the sale occurs.[11]

A simple illustration may be used to demonstrate the general scheme of the installment method and the potential benefits accruing to the taxpayer. Assume a seller and buyer enter into a contract for the sale of land that the seller has held for investment purposes and in which he has an adjusted basis of $50,000. The contract price is $100,000 and is to be paid over four years, at $25,000 a year, together with interest at 12% per annum. In determining the amount of gain to be recognized for each year, the gross profit percentage must first be computed. The ratio of the gross profit ($50,000)[12] to the contract price ($100,000) will result in the gross profit percentage (50%). Thereafter, the gross

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tax purposes was first recognized by Congress in 1918. Treas. Reg. 33, art. 117, T.D. 2690, 20 Treas. Dec. 187 (1918). Congress reasoned that liquidity problems might otherwise arise when insufficient cash is received in the year of sale. *Id.* In Commissioner v. South Tex. Lumber Co., 333 U.S. 496 (1948), the Supreme Court summarized the legislative history of the Act, stating, "The installment basis of reporting was anacted . . . to relieve taxpayers who adopted it from having to pay an income tax in the year of sale based on the full amount of anticipated profits when in fact they had received in cash only a small portion of the sales price." *Id.* at 503; *see also* S. REP. No. 52, 69th Cong., 1st Sess. 14-15 (1926) (purpose of the installment method, *reprinted in* 1939-1 C.B. 332, 346); Emory, *The Installment Method of Reporting Income: Its Election, Use, and Effect;* 53 CORNELL L. REV. 181, 186-88 (1968) (same).

[9] I.R.C. § 453(c) (West Supp. 1981). As early as 1919, article 42 of regulation 45 set forth the general rule for reporting income from installment sales that has been carried forward through the new Act. Treas. Reg. 45, art. 42, T.D. 2831, 21 Treas. Dec. 185 (1919). The rule stated that in a sale or contract for sale of personal property on the installment plan, income recognized by the seller was to be that proportion of each installment payment which the gross profit to be realized bore to the total contract price. *Id.* at 185-86. *See generally* 2 J. MERTENS, *supra* note 4, § 15.02 (history of the installment method); Emory, *supra* note 8, at 186-91 (same).

[10] Martin v. Commissioner, 61 F.2d 942, 944 (2d Cir. 1932), *cert. denied,* 289 U.S. 737 (1933); Rev. Rul. 70-430, 1970-2 C.B. 51, 52.

[11] I.R.S., U.S. DEP'T OF TREASURY, PUB. No. 334, *supra* note 5, at 78; *see* I.R.C. § 165 (1976) (deductions for losses).

[12] The installment method merely postpones the taxation of income and does not actually delay the date of realization. Rev. Rul. 60-68, 1960-1 C.B. 151, 152.

profit percentage (50%) times the actual payments received during the year ($25,000) will equal the gain to be recognized for the taxable year ($12,500). As a result, the installment method avoids possible liquidity problems that could result if the seller were required to recognize the entire gain prior to receipt of all the installment payments.[13] In addition, the impact of the graduated tax rates is lessened by spreading the gain over the years during which payments are received.[14] Similarly, if the seller anticipates a decline in income or foresees potential losses in later years, deferral of gain to those years may result in tax savings.[15] Another advantage may be obtained by utilizing the deferred tax dollars to generate additional income.[16]

Use of the installment method, however, is not without drawbacks. A major disadvantage to the seller is that he assumes a risk of nonpayment that could otherwise be avoided by acceptance of full payment.[17] In addition to the issue of security, other problems have been encountered because of the unique character of the installment method as a relief provision. Unlike other relief measures such as the casualty loss provisions that are generally outside the scope of taxpayer control, the installment method affords the seller the opportunity to conform with the requirements of the installment provisions.[18] Thus, an uninformed or careless seller might preclude his right to installment treatment by including a provision in the contract of sale that is contrary to the basic requirements for installment reporting.[19] Unfamiliarity with the installment provisions, coupled with taxpayer abuse of those provisions, has resulted in controversy and litigation regarding practically every concept in the statutory

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[13] Heinlen, *Inside Installment Sales — Rushing and Its Progeny*, 38 INST. ON FED. TAX'N § 20.03[1], at 20-9 (1980).

[14] *Id.* § 20.03[1][a].

[15] *Id.* § 20.03[1][b].

[16] *Id.* § 20.03[1][e]; *see* Giljum, *Installment Sales*, 48-4th TAX MGMT. (BNA) A-5 to -6 (1975) (advantages of installment reporting); Chandler, *The Installment Sales Provisions of Internal Revenue Code Section 453*, 7 RUT.-CAM. L. REV. 428, 430-31 (1976) (same).

[17] Giljum, *supra* note 16, at A-6.

[18] Ditkoff & Shaefer, *Installment Sales: Pitfalls, Problems, and Planning*, 24 TUL. TAX INST. 254, 254 (1975).

[19] Giljum, *supra* note 16, at A-6.

framework of installment reporting.[20] Most recently, the Installment Sales Revision Act of 1980[21] (the Act) was enacted to liberalize and to simplify[22] the rules governing installment sales reporting and to prevent abuse of the rules by related parties.[23]

To demonstrate the significance of the Act, this comment briefly sets out the statutory framework for installment reporting as it existed before the 1980 enactment and then analyzes the provisions of the Act, with an explanation of the problems encountered under prior law that necessitated the enactment of these provisions.

I. Statutory Framework Before the Installment Sales Revision Act of 1980

In general, the installment method as originally set forth in section 453 of the 1954 Internal Revenue Code[24] was an elective provision,[25] which was available for three categories of sales: (1) sales of personal property on the installment method by dealers;[26] (2) sales of real property;[27] and (3) casual sales of personal property, other than inventory, where the sales price exceeded $1,000.[28] Disqualification, however, resulted from sales that otherwise fell into categories (2) and (3) if payments in the year of

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[20] Ditkoff & Shaefer, *supra* note 18, at 254. *See generally* 4 B. Bittker, Federal Taxation of Income, Estates, and Gifts 106-5 to -27 (1981) (interpretive problems under section 453); Ditkoff & Shaefer, *supra* note 18, at 255-77 (same).

[21] Installment Sales Revision Act of 1980, Pub. L. No. 96-471, 94 Stat. 2247 (codified as amended at I.R.C. §§ 453, 453A, 453B (West Supp. 1981)).

[22] *See* 125 Cong. Rec S5184 (daily ed. May 2, 1979) (statement of Sen. Long).

[23] I.R.C. §§ 453(e), 453(g), 453(h)(1)(C), 453B(f)(2), 691(a)(5)(B), 1239(b) (West Supp. 1981), pertaining to related parties, are discussed at *infra* notes 90-198, 216-17, 299, 308 and accompanying text.

[24] Internal Revenue Code of 1954, ch. 736, § 453, 68A Stat. 3, 154-56 (current version at I.R.C. §§ 453, 453A, 453B (West Supp. 1981)). For a discussion of the statutory form of § 453, including amendments, see Emory, *supra* note 8, at 184-91. *See generally* Ginsburg, *Taxing the Sale for Future Payment*, 30 Tax L. Rev. 469, 499-593 (1975) (outlining law through 1975).

[25] Treas. Reg. § 1.453-8(b)(1) (1958) (repealed and replaced by I.R.C. § 453(b), (d) (West Supp. 1981)); *see infra* notes 83-89 and accompanying text.

[26] I.R.C. § 453(a) (1976) (current version at *id.* § 453A (West Supp. 1981)).

[27] *Id.* § 453(b)(1)(A) (1976) (current version at *id.* § 453(b) (West Supp. 1981)).

[28] *Id.* § 453(b)(1)(B) (1976) (current version at *id.* § 453(b)(1)-(2) (West Supp. 1981)).

sale exceeded thirty percent of the selling price.[29] An additional requirement for sales of property in categories (2) and (3) was that the total purchase price must not have been payable in a lump sum in a taxable year subsequent to the year of sale.[30]

Because the installment method is a method of accounting, once it was elected by a dealer in personal property it was revocable only with the consent of the Internal Revenue Service (the Service).[31] With regard to sales of realty and casual sales of personal property, however, an election of the installment method did not commit the taxpayer to future use of installment reporting.[32] Thus, for two or more sales within a taxable year, the installment method could be used in the manner best suited to the taxpayer's particular circumstances.

Without the installment method, a taxpayer reporting on the accrual basis would be required to report the entire profit in the year of sale.[33] Moreover, the Service could also force a cash-basis taxpayer who receives installment obligations that are equivalent to cash[34] to report his entire gain in the year of sale.[35] Thus, the installment provisions have served as a useful tool to defer tax liability pending receipt of the purchase price of property sold. Nevertheless, commentators have noted the lack of simplicity and equity that previously marked the tax treatment of installment sales.[36] In addition, major interpretive problems

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[29] *Id.* § 453(b)(2)(B) (eliminated under current version at *id.* § 453(b) (West Supp. 1981)).

[30] Treas. Reg. § 1.453-2(b), T.D. 6682, 1963-2 C.B. 197, 198 (revoked by I.R.C. § 453(b)(1) (West Supp. 1981)); *see infra* notes 70-79 and accompanying text.

[31] I.R.C. § 453(c)(4) (1976) (repealed by the Installment Sales Revision Act of 1980); Treas. Reg. § 1.453-8(c), T.D. 7104, 1971-1 C.B. 140, 141. The regulation specifically indicates that a dealer changing from the accrual basis to installment reporting may retroactively revoke the election without consent during the three-year period following the filing date of the return for the year of change. *Id.* § 1.453-8(d)(2), T.D. 7104, 1971-1 C.B. 140, 141. Once the statutory period has run, abandonment of the installment method is a change of accounting method requiring I.R.S. permission. 4 B. BITTKER, *supra* note 20, at 106-9; *see* 10 FED. TAX COORDINATOR 2D (RIA) ¶G-6054 (1981) (election and revocation). For a discussion of changes of accounting method, see generally 4 B. BITTKER, *supra* note 20, at 105-122 to -130.

[32] 4 B. BITTKER, *supra* note 20, at 106-3.

[33] 10 FED. TAX COORDINATOR 2D (RIA) ¶G-6200 (1981).

[34] *See* 4 B. BITTKER, *supra* note 20, at 105-32 (cash equivalents).

[35] 10 FED. TAX COORDINATOR 2D (RIA) ¶G-6200 (1981).

[36] *See* Giljum, *supra* note 16, at A-1 (§ 453 technicalities that are potential tax traps

with the installment rules have arisen because of (1) inadequate detail regarding contract price, selling price, payments in the year of sale, and determination of gross profit; (2) the method and timing of electing installment treatment; and (3) the effect of disposing or canceling installment obligations.[37] An analysis of the 1980 Act and its potential effect in this highly litigated area of the law follows.

II. Analysis of the New Act

A. *Overview*

On October 19, 1980, the Installment Sales Revision Act of 1980,[38] which was the major tax simplification legislation enacted by the ninety-sixth Congress, became law. Except for certain structural changes and an amendment to the election of the installment method by an accrual basis dealer, the significant

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for the unwary); Chandler, *supra* note 16, at 431-53 (same); Ditkoff & Shaefer, *supra* note 18, at 266-77 (same); Emory, *supra* note 8, at 191-279 (same); Emory & Hjorth, *An Anlysis of the Changes Made by the Installment Sales Revision Act of 1980 — Part I*, 54 J. Tax'n 66, 66 (1981) (same); Ginsburg, *supra* note 24, at 499-576 (same). Professor Ginsburg's article brought about congressional consideration of the problems and pitfalls inherent in the installment sales provisions. Many of the proposals advocated by Ginsburg were incorporated into the new Act. *See id.* at 471-98 (proposals for reform). Primary emphasis was placed on the difficulty in obtaining the proportionate basis recovery, which is the main thrust of § 453, and the uncertainty as to when the cost recovery method is applicable. Ginsburg, *supra* note 24, at 506-24, 527-31, 556-76.

[37] *See generally* Chandler, *supra* note 16, at 431-53; Ditkoff & Shaefer, *supra* note 18, at 256-77; Emory, *supra* note 8, at 191-279; Ginsburg, *supra* note 24, at 506-49.

[38] Installment Sales Revision Act of 1980, Pub. L. No. 96-471, 94 Stat. 2247 (codified as amended at I.R.C. §§ 453, 453A, 453B (West Supp. 1981)). Section 6 of the Act contains the provisions for effective dates. Generally, application is effective for sales, dispositions, cancellations, bequests, and reacquisitions of real property occurring after the date of enactment. S. Rep. No. 1000, 96th Cong., 2d Sess. 6, *reprinted in* 1980 U.S. Code Cong. & Ad. News 4696, 4700-01 [hereinafter cited as 1980 S. Rep.]; H.R. Rep. No. 1042, 96th Cong., 2d Sess. 4 (1980) [hereinafter cited as 1980 H.R. Rep.]. Provisions eliminating both the 30% ceiling on receipt of initial payment and the requirement of two or more payments are effective for sales in taxable years ending after the date of enactment. 1980 S. Rep., *supra*, at 6, *reprinted in* 1980 U.S. Code Cong. & Ad. News 4696, 4701. Rules providing for related party installment sales apply to transactions after May 14, 1980. *Id.*, *reprinted in* 1980 U.S. Code Cong. & Ad. News 4696, 4701; 1980 H.R. Rep., *supra*, at 4. The provision relating to the distribution of installment obligations received in connection with a 12-month corporate liquidation under § 337 (West 1978 & Supp. 1982) is effective for distributions made after March 31, 1980. 1980 S. Rep., *supra*, at 6, *reprinted in* 1980 U.S. Code Cong. & Ad. News 4696, 4701; 1980 H.R. Rep., *supra*, at 4.

changes to the prior enactments relate only to sales of realty and nondealer sales of personal property.[39] The basic concepts and the function of the installment method were left unchanged.[40] Regarding structural changes, the rules, previously contained in section 453, have been separated into three distinct Code sections for simplification purposes.[41] Section 453 presently contains only the rules for reporting sales of real property and casual sales of personal property.[42] Section 453A provides for the rules concerning the use of the installment method by dealers in personal property.[43] Finally, section 453B governs the disposition of installment obligations.[44]

B. Initial Payment Limitation

One of the most significant revisions made by the Act is the expansion of installment coverage by eliminating the requirement that, in the case of sales of realty or nondealer personal property, payments received in the year of sale may not exceed thirty percent of the selling price.[45] Although the limitation at first glance appears to be simple in application, both the House of Representatives and Senate committee reports recognize that this arbitrary ceiling has resulted in confusion and litigation,

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[39] 1980 S. REP., *supra* note 38, at 8, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4701; 1980 H.R. REP., *supra* note 38, at 6.

[40] 1980 S. REP., *supra* note 38, at 7, *reprinted in* 1980 U.S. Code Cong. & Ad. News 4696, 4701-02, states:

> The function of the installment method of reporting income is to permit the spreading of the income tax over the period during which payments of the sales price are received. Thus, the installment method alleviates possible liquidity problems which might arise from the bunching of gain in the year of sale when a portion of the selling price has not been actually received.

The definition of the installment method has continued unchanged. *See* I.R.C. § 453(c) (West Supp. 1981) (providing definition). Furthermore, as under prior law, the installment reporting provisions do not apply to losses from an installment sale; they apply only to gains. 1980 S. REP., *supra* note 38, at 7, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4701; 1980 H.R. REP., *supra* note 38, at 5.

[41] 1980 S. REP., *supra* note 38, at 7, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4701.

[42] I.R.C. § 453 (West Supp. 1981).

[43] *Id.* § 453A.

[44] *Id.* § 453B.

[45] *See* Mylan, *Installment Sales Revision Act of 1980*, 17 WILLAMETTE L.J. 303, 305-06 (1981) (history of limitation on receipt of payments in year of sale).

and has often "operated as a trap for the unwary."[46] For example, inadvertent disqualification has occurred where the sales contract provided for no interest on the installment debt.[47] In a contract without stated interest, section 483 becomes operative to reduce the selling price by the amount required to be treated as unstated interest.[48] Thus, payments received in the year of sale, originally calculated to be within the limitation, may, as a result of section 483, exceed thirty percent of the selling price.[49]

A number of other problems arose as a result of the thirty percent initial payment ceiling with respect to sales subject to an existing mortgage or sales where an existing mortgage was assumed. The basic rule has been that while the amount of the mortgage should be taken into account in determining the sales price,[50] it is not to be regarded as payment received by the seller in the year of sale except to the extent the mortgage exceeds the seller's adjusted basis in the property.[51] An uninformed or ill-advised taxpayer could have been disqualified from using the installment method by his failure to consider the amount of mortgage in excess of his adjusted basis as a payment in the year of sale. Sellers who have recognized this potential hazard have structured a "wraparound" mortgage arrangement to meet the installment sales provisions.[52] Under the wraparound mortgage

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[46] 1980 S. REP., *supra* note 38, at 8, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4702-03; 1980 H.R. REP., *supra* note 38, at 6.

[47] 1980 S. REP., *supra* note 38, at 8, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4703. Regardless of the degree of the taxpayer's noncompliance with the 30% limitation, the entire gain had to be recognized in the year of sale. *Id., reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4703.

[48] *See* 4 B. BITTKER, *supra* note 20, at 106-13 (discussing unstated interest in deferred payment sales).

[49] Where the installment debt is a corporate obligation issued at a discount, a similar disqualification can result because the amount treated as original issue discount is not included as part of the selling price. Treas. Reg. § 1.453-3(b)(3), T.D. 7197, 1972-2 C.B. 238, 239.

[50] *See* Burnet v. S. & L. Bldg. Corp., 288 U.S. 406, 410 (1933) (mortgage on property included in selling price); Treas. Reg. 1.453-4(c)(1958) (mortgage considered in selling price whether buyer assumes or takes subject to).

[51] *See* Republic Petroleum Corp. v. United States, 613 F.2d 518, 522 (5th Cir. 1980); Rev. Rul. 71-543, 1971-2 C.B. 223, 223; *cf.* Maddox v. Commissioner, 69 T.C. 854, 858-59 (1978) (buyer's pay off of seller's mortgage, with proceeds of new mortgage held to be payment in year of sale).

[52] 1980 S. REP., *supra* note 38, at 9, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS

scheme, the purchaser agrees neither to assume nor to take subject to the indebtedness and makes payments to the seller, who continues to pay the mortgagee.[53] Uncertainty and litigation have resulted over the validity of this type of arrangement.[54]

Another related problem has involved the treatment of selling expenses when determining whether the mortgage assumed or taken subject to by the purchaser exceeded the adjusted basis of the property sold.[55] In *Kirschenmann v. Commissioner*,[56] the Ninth Circuit Court of Appeals reversed an earlier Tax Court decision and held that commissions and other expenses of sale were proper additions to adjusted basis.[57] Benefit accrued to the seller by this rationale because the additions reduced the amount by which the mortgage exceeded the adjusted basis and, as a result, reduced the amount treated as payment in the year of sale.[58] The Internal Revenue Service has recognized that the court's reasoning in *Kirschenmann* may distort the meaning of

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4696, 4703, cites Wyndelts & Campbell, *Installment Reporting Need Not Be Lost When Year-of-Sale Payments Are More Than 30%*, 20 TAX'N FOR ACCT. 328 (1978), and Ginsburg, *supra* note 24, at 488, for explanation and application of wraparound mortgages. For other discussions of the effect of wraparound mortgages, see generally Gallagher, *Wraparound Mortgages and Deferred Payment Sales of Real Property*, 56 TAXES 400-04 (1978), and Miller, *Installment Sales of Mortgaged Realty — Another View*, 6 J. REAL EST. TAX'N, 514-32 (1978).

[53] Giljum, *supra* note 16, at A-28.

[54] *See* Goodman v. Commissioner, 74 T.C. 684, 715 (1980) (where purchaser gave bank right to make payments on pre-existing mortgage with funds received from the purchaser, held to be "subject to" mortgage); Estate of Lambeth v. Commissioner, 31 T.C. 302, 316 (1958) (purchaser took "subject to" only to the extent mortgage remained after title was conveyed), *nonacq.* 1959-1 C.B. 6; Stonecrest Corp. v. Commissioner, 24 T.C. 659, 667 (1955) (no assumption where seller retained title), *nonacq.* 1956-1 C.B. 6. *But see* Voight v. Commissioner, 68 T.C. 99, 111-13 (1977) (execution of guarantee of mortgage by purchaser was assumption of mortgage), *aff'd per curiam*, 614 F.2d 94 (5th Cir. 1980); Waldrep v. Commissioner, 52 T.C. 640, 645-46 (1969) (purchaser primarily liable for tax lien held to be assumption of mortgage), *aff'd per curiam*, 428 F.2d 1216 (5th Cir. 1970).

[55] Where selling expenses are permitted to be added to the adjusted basis of property sold, any excess of the mortgage indebtedness assumed or taken subject to that would be treated as payment in the year of sale is correspondingly reduced. Giljum, *supra* note 16, at A-27 to -28; *see* 2 J. MERTENS, *supra* note 4, § 15.20 (treatment of expenses of sale).

[56] 488 F.2d 270 (9th Cir. 1973), *rev'g* 57 T.C. 524 (1972).

[57] 488 F.2d at 273.

[58] *See* Giljum, *supra* note 16, at A-28 (illustrating the tax consequences of the alternate treatment of selling expenses); Chandler, *supra* note 16, at 441-42 (same).

capital expenditure as defined in section 1016(a)[59] and, therefore, has announced its opposition to that decision.[60] Thus, proper treatment of selling expenses for purposes of the thirty percent initial payment rule is viewed in the committee reports as another instance that fostered litigation and confusion.[61]

Taxpayers have also been inadvertently disqualified from installment reporting because of the confusion that has resulted when the buyer pays some of the seller's obligations, other than the mortgage, in the year of sale.[62] After much litigation,[63] the Service, in a revenue ruling, finally acknowledged that the buyer's assumption and payment of these secured and general, unsecured liabilities of the seller would not be included as initial payments to the seller.[64] The seller, however, was required to establish that the liabilities were incurred in the ordinary course of business and not for purposes of avoiding the thirty percent initial payment ceiling.[65] Under the ruling, the avoidance test in-

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[59] I.R.C. § 1016(a) (1976 & Supp. III 1979). The particular problem becomes evident when noting the distinction between commissions paid for the purchase of an asset and commissions paid for the sale of an asset. In the former case commissions should be added to basis as a cost of acquiring the asset, while in the latter case such expenditures should reduce the selling price because they do not enhance the asset's value or prolong its life. Chandler, *supra* note 16, at 443; *see* Griffin v. Commissioner, 19 B.T.A. 1243, 1246 (1930) (rationale for deducting selling expenses from sales price).

[60] Rev. Rul. 74-385, 1974-2 C.B. 153.

[61] 1980 S. REP., *supra* note 38, at 9, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4703; H.R. REP., *supra* note 38, at 7.

[62] Hammond, *An Analysis of the Installment Sales Revision Act of 1980*, 42 ALA. LAW. 63, 67 (1981). Prior to 1973 the Service took the position that current liabilities that arose in the course of the seller's business and that were assumed by the purchaser pursuant to a sale of that business were to be treated as payments in the year of sale if liquidated within that year. Rev. Rul. 60-52, 1960-1 C.B. 186, 186-87. The courts, however, have generally refused to accept the Service's ruling. *See infra* note 63.

[63] *See* Irwin v. Commissioner, 390 F.2d 91, 94-96 (5th Cir. 1968) (assumption of current liabilities was in the nature of mortgage indebtedness), *rev'g* 45 T.C. 544, 554 (1966); Marshall v. United States, 241 F. Supp. 30, 32-33 (S.D. Cal. 1964) (same), *aff'd*, 357 F.2d 294 (9th Cir. 1966). *But see* Horneff v. Commissioner, 50 T.C. 63, 70-71 (1968) (regulations referred to the assumption of mortgage indebtedness, not current liabilities).

[64] Rev. Rul. 73-555, 1973-2 C.B. 159. The ruling stated, however, that if the total of all the liabilities assumed exceeded the adjusted basis of the property, such excess would be included as payment in the year of sale. *Id.* at 160.

[65] *Id.* Furthermore, the Service indicated that when payment of the seller's liabilities is directed to be paid out of the purchase price, such payment will be considered as a payment in the year of sale. *Id.; see* Bostedt v. Commissioner, 70 T.C. 487, 492 (1978) (payment of the seller's commission expenses by buyer constituted payment in the year

volved a subjective determination of purpose; thus, continued controversy was likely.[66]

In the temporary regulations issued for the new Act, the rule remains that a mortgage assumed or taken subject to by the buyer will be treated as a payment in the year of sale only to the extent that the mortgage exceeds the seller's adjusted basis.[67]

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of sale).

[66] 1980 S. REP., *supra* note 38, at 10, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4704; *see* Rev. Rul. 73-555, 1973-2 C.B. 159, 160 (determination of purpose based on facts of each case). Unintentional disqualification from installment reporting has also resulted from the varying treatment given evidences of indebtedness transferred to the seller. *See generally* Giljum, *supra* note 16, at A-24 to -27 (treatment of evidences of indebtedness); Chandler, *supra* note 16, at 446-47 (same). The committee reports do not address the problems that occurred under prior law in determining payment for purposes of the 30% limitation when evidences of indebtedness were transferred to the seller. Discussion of the proper treatment of such transfers is, however, necessary for correctly applying the gross profit percentage to payments received in determining the gain to be recognized. *See infra* note 69. Generally, evidences of indebtedness of a third party contained in the initial payments of the buyer will be considered as payments received in the year of sale. Elmore v. Commissioner, 15 B.T.A. 1210, 1212-13 (1929); *see* Freeman Trust v. Commissioner, 303 F.2d 580, 584 (8th Cir. 1962) (distribution of notes in redemption of corporate stock was third-party indebtedness), *aff'g* 36 T.C. 779 (1961); Tombari v. Commissioner, 299 F.2d 889, 891-92 (9th Cir. 1962) (determination of fair market value); Caldwell v. United States, 114 F.2d 995, 997 (3rd Cir. 1940) (third party included corporation controlled by purchaser); Carl F. Holmes, 55 T.C. 53, 55 (1970) (guarantee of third-party obligation by the purchaser did not convert obligation into one of the purchaser). Evidences of indebtedness of the purchaser are not ordinarily included in computing payments in the year of sale. Treas. Reg. § 1.453-6(a) (1958). The Tax Reform Act of 1969 added two exceptions to this general rule. First, buyer obligations that are payable on demand and, second, buyer obligations that are readily tradable and issued by a corporation or a government or political subdivision thereof shall not be treated as evidences of indebtedness of the purchaser. I.R.C. § 453(b)(3) (1976) (current version at *id.* § 453(f)(3)-(4) (West Supp. 1981)). Ordinary promissory notes are not to be included within the category of indebtedness that is treated as payments in the year of sale. S. REP. No. 552, 91st Cong., 1st Sess. 146, *reprinted in* 1969 U.S. CODE CONG. & AD. NEWS 2027, 2178 [hereinafter cited as 1969 S. REP.]. Congress's intent in this legislation was to ensure that obligations essentially equivalent to cash be treated as initial payments because there is no reason for postponing gain where the seller receives highly liquid debt instruments. *Id.*, *reprinted in* 1969 U.S. CODE CONG. & AD. NEWS 2027, 2178; H.R. REP. No. 413, 91st Cong., 1st Sess. 107-08, *reprinted in* 1969 U.S. Code Cong. & Ad. News 1645, 1756 [hereinafter cited as 1969 H.R. REP.]; *see* Commissioner v. South Tex. Lumber Co., 333 U.S. 496, 503 (1948) (taxpayer may not, as to the same taxable transaction, report in part on cash receipts basis and in part on accrual basis). *See generally* 10 FED. TAX COORDINATOR 2D (RIA) ¶¶ G-6245 to -6260 (determining amount received in year of sale).

[67] Temp. Treas. Reg. § 15A.453-1(b)(3)(i), T.D. 7768, 1981-1 C.B. 298, 299-300. Additionally, the Service has conceded to the Ninth Circuit Court of Appeals' holding in

Furthermore, the regulations indicate that regardless of whether title passes to the buyer or remains in the seller, who continues making payments to the mortgagee, any mortgage encumbering the property will be considered as assumed or taken subject to.[68] Thus, the excess of the mortgage over the basis of the property sold will constitute payment.[69]

C. *Elimination of Two-Payment Rule and Selling Price Requirement*

The regulations under prior law required that a taxpayer make a minimum of two payments to be eligible for installment reporting.[70] Although these regulations were silent on whether the seller must receive payments over at least two taxable years, the Service has held that the concept of an installment sale precludes the use of section 453 where the sales contract requires the total purchase price to be paid in a taxable year subsequent to the year of sale.[71] Moreover, the Service[72] has reasoned that

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Kirschenmann. See supra notes 55-60 and accompanying text. Selling expenses under the temporary regulations may be added to the seller's adjusted basis in determining whether an existing mortgage exceeds adjusted basis. Temp. Treas. Reg. § 15A.453-1(b)(3)(i), T.D. 7768, 1981-1 C.B. 298, 299-300. As under prior law, the assumption of a mortgage by the seller in anticipation of a disposition will be treated as payment in the year of sale. *Id.* § 15A.453-1(b)(2)(iv), 1981-1 C.B. 298, 299; Rev. Rul. 73-555, 1973-2 C.B. 159, 160; *cf.* Shubin v. Commissioner, 67 F.2d 199, 200 (3rd Cir. 1933) (proceeds of loan that purchaser paid to seller held to be part of initial payment to seller because seller was secondarily liable on the loan). *But see* Denco Lumber Co. v. Commissioner, 39 T.C. 8, 13-15 (1962) (mortgaging property prior to sale was part of general business practice and such mortgages held to be evidences of indebtedness of the purchaser).

[68] Temp. Treas. Reg. § 15A.453-1(b)(3)(ii), 1981-1 C.B. 298, 300. While in the past the courts determined the validity of the wraparound mortgage arrangements on a case by case basis, a more definite precept has emerged under the temporary regulations. *See supra* notes 51-54 and accompanying text.

[69] It should be noted that while a proper computation of "payment" was necessary under old law to determine whether the 30% limitation had been met, such calculation will remain necessary under the 1980 legislation for applying the gross profit percentage. Thus, where the regulations, rulings, and cases cited above were relevant before the new Act to determine payment for purposes of qualification for the installment method, the temporary regulations along with the other aforementioned authorities will be useful in ascertaining when payment is received for income recognition purposes. *See* Mylan, *supra* note 45, at 308 (relevance of prior authority and temporary regulations).

[70] Treas. Reg. § 1.453-2(b), T.D. 6682, 1963-2 C.B. 197, 198.

[71] Rev. Rul. 69-462, 1969-2 C.B. 107, 108 (amplified by Rev. Rul. 71-595, 1971-2 C.B. 223, 224). Although these rulings were, under the facts, concerned specifically with dispo-

the installment method should not be available unless the sales contract provides for two or more payments on the purchase price in two or more years.[73] While courts generally have agreed with this strict interpretation,[74] Congress has recognized that the two-payment rule can result in different tax consequences for substantially similar transactions.[75] For instance, a taxpayer who received no down payment with the entire contract price due in a subsequent year was not allowed to use installment reporting, yet the installment method was available to a taxpayer who, under a similar contract, received a small down payment.[76] Because the ability to pay income tax from the sales proceeds in either situation is virtually identical, the new Act eliminates the requirement that a sale must be in two or more payments to qualify for installment reporting.[77] For all sales of real property and casual sales of personal property,[78] the new Act defines an

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sitions of real property, a subsequent ruling indicates the two-payment rule was also applicable to dealers in personal property. *See* Rev. Rul. 74-442, 1974-2 C.B. 152, 152. The rationale would likewise appear to extend to casual sales of personal property. Giljum, *supra* note 16, at A-16.

[72] Rev. Rul. 69-462, 1969-2 C.B. 107, 108.

[73] *Id.* at 108; *see supra* note 30 and accompanying text.

[74] *See* Baltimore Baseball Club, Inc. v. United States, 481 F.2d 1283, 1287 (Ct. Cl. 1973) (nature of term "installment" implies that at least two payments be made); 10-42 Corp. v. Commissioner, 55 T.C. 593, 597 (1971) (must be more than a single payment in the future to qualify under the statute); Prendergast v. Commissioner, 22 B.T.A. 1259, 1262 (1931) (installment method not permissible because total sales price received in year subsequent to year of sale).

[75] 1980 S. REP., *supra* note 38, at 10, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4704; 1980 H.R. REP., *supra* note 38, at 8.

[76] 1980 S. REP., *supra* note 38, at 10, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4704-05.

[77] I.R.C. § 453(b)(1) (West Supp. 1981); 1980 S. REP., *supra* note 38, at 10, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4704-05; 1980 H.R. REP., *supra* note 38, at 8.

[78] The Senate report anticipates that the Treasury Department will prescribe regulations to extend a similar rule to deferred payment sales by dealers in personal property. 1980 S. REP., *supra* note 38, at 11, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4705. Should this occur, dealers will reap a significant tax benefit that Congress may not have intended. In the usual situation, a dealer selling on the accrual basis under a contract requiring a single payment in a year subsequent to that of the sale must recognize the entire gain in the taxable year in which the sale occurs. Yet, if such a dealer were allowed to qualify for installment reporting, he would be entitled to elect deferral of gain until the payment was actually received. *See* Mylan, *supra* note 45, at 305 (congressional intent regarding extension of the one-payment rule to dealers in personal prop-

installment sale as "a disposition of property where at least one payment is to be received after the close of the taxable year in which the disposition occurs."[79]

In addition, to facilitate taxpayer compliance and to terminate disputes over whether a sale of personal property exceeding $1,000 was actually a multiple sale[80] of individual items, each with a price under $1,000, the Act eliminates the $1,000 selling price requirement in the case of nondealer personal property.[81] As a result of the elimination of the thirty percent ceiling, the two-payment rule, and the selling price requirement, qualification for installment reporting now simply requires that less than one hundred percent of the sales price be received in the year of sale.[82]

D. Election of Installment Reporting

Prior law required the taxpayer to make an election for reporting under the installment provisions.[83] As such, Congress recognized that disqualification could result where the taxpayer failed to comply with the technical requirements for proper election of the installment method.[84] Therefore, as a simplification

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erty). The language used governing installment sales by dealers in personal property contains the terms "payments" on the "installment plan." *Id.* Furthermore, after the enactment of the new legislation, Senator Long stated before the Senate Finance Committee that "there is no intention whatever that dealer transactions which do not meet the ordinary understanding of sales on the 'installment plan' are to qualify for installment reporting." 126 CONG. REC. S16,536 (daily ed. Dec. 13, 1980) (remarks of Sen. Long). Thus, eligibility for use of the installment method by dealers in personal property may be limited to sales encompassing two or more payments. *See* I.R.C. § 453A(a)(1) (West Supp. 1981) (referring to installment payments).

[79] I.R.C. § 453(b)(1) (West Supp. 1981).

[80] *See* Chandler, *supra* note 16, at 443-45 (multiple asset dispositions).

[81] I.R.C. § 453(b)(1) (West Supp. 1981); 1980 S. REP., *supra* note 38, at 11, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4705; 1980 H.R. REP., *supra* note 38, at 9.

[82] Installment Sales Revision Act of 1980, Pub. L. No. 96-471, 94 Stat. 2247 (codified as amended at I.R.C. §§ 453, 453A, 453B (West Supp. 1981)).

[83] Treas. Reg. § 1.453-8(b)(1) (1958) (repealed and replaced by I.R.C. § 453(d) (West Supp. 1981)). In addition, there could be no evidence of a position that had been taken with respect to the sale that was inconsistent with the installment election. Rev. Rul. 65-297, 1965-2 C.B. 152, 152-53.

[84] 1980 S. REP., *supra* note 38, at 11, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4705; 1980 H.R. REP., *supra* note 38, at 9. In Pacific Nat'l Co. v. Welch, 304

measure, the new legislation provides that the installment method automatically will apply to a qualified sale of realty or nondealer personal property except where the seller affirmatively elects not to invoke the provisions.[85] Generally, an election not to have the installment method apply to a deferred payment sale must be made on or before the due date, including any extensions granted, for filing the income tax return for the year of sale.[86] An effective election may be made by reporting the entire gain in the year of sale.[87] Furthermore, once the election is made, it is irrevocable except with the consent of the Service.[88] The temporary regulations indicate that consent will not be extended in circumstances where the revocation is motivated by tax avoidance purposes or when the taxable year in which any payment was received is closed.[89]

E. Related-Party Sales

Prior to the 1980 enactment, controversy resulted when a taxpayer attempted to obtain the benefits of the installment method and retain the proceeds from a subsequent resale within the family group.[90] Qualification for such advantage was obtained by the use of a "related-party" installment transaction or some variation of this technique.[91] Typically, an installment sale

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U.S. 191, 194-95 (1938), the taxpayer was barred from filing an amended return or claim for refund because his prior inclusion of the entire gain as income in the year of sale precluded the use of the installment method.

[85] I.R.C. § 453(d)(1) (West Supp. 1981).

[86] *Id.* Late elections will be permitted only when the Service finds reasonable cause for failing to make a timely election under the particular facts of each case. Temp. Treas. Reg. § 15A.453-1(d)(3)(ii), *supra* note 67, at 309.

[87] Temp. Treas. Reg. § 15A.453-1(d)(3)(i), *supra* note 67, at 309.

[88] I.R.C. § 453(d)(3) (West Supp. 1981).

[89] Temp. Treas. Reg. § 15A.453-1(d)(4), *supra* note 67, at 309.

[90] The Service has generally opposed these transactions in both published and private rulings. *See infra* notes 114-42.

[91] Characteristic of the related-party scheme is a sale by a taxpayer to a relative or controlled business entity who or which promptly resells the property to an independent third party. Ruppert, *Section 453: Installment Sales Involving Related Parties or Trusts*, 29 DE PAUL L. REV. 47, 48 (1979). Another pattern involves the use of a trust as the middle party. *Id.* A third alternative, which has not met with much success, is the use of an escrow agent as the intermediary. Note, *Installment Sales to Irrevocable Trusts: Section 453 of the Internal Revenue Code and the Rushing Trust*, 65 IOWA L. REV. 398, 404 (1980). The third-party purchaser in an escrow arrangement generally pays

involving a related party employed three separate parties and two sales. In the classic example,[92] the taxpayer (seller) initiated the transaction by making a deferred payment sale to the related-party purchaser (related party). Immediately thereafter, the related party effected a cash resale to an independent third-party purchaser (purchaser). Thus, the seller achieved tax deferral until the related party paid the installment obligations, even though the related party had received the entire cash proceeds from his resale.[93] Moreover, the related party recognized little, if any, gain upon resale because his adjusted basis would approximate the selling price to the purchaser.[94]

Theoretical problems concerning the doctrine of constructive receipt and the doctrine prohibiting form over substance have arisen from the related-party sales structure.[95] Unfortunately, application of the doctrines by the Internal Revenue Service and the courts has resulted in inconsistent precedent.[96] The

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an amount equal to the unpaid portion of the sales contract to an escrow agent, who holds the funds for the seller. *Id.* at 400; *see* Pozzi v. Commissioner, 49 T.C. 119, 120-25 (1967) (receipt of total sales price available to seller at time of sale).

[92] Rev. Rul. 73-157, 1973-1 C.B. 213, outlines two situations. The first arrangement involved an installment sale by a taxpayer to his son, and the second involved a similar sale by a taxpayer to his controlled corporation. Pursuant to a prearranged plan, the intermediary in each case resold the property to a third party. Although the Service neglected to discuss the relationship of the parties in each of the original transactions, a conclusion was reached that the son and the corporation were conduits for carrying out the taxpayers's schemes. *Id.* at 213.

[93] 1980 S. REP., *supra* note 38, at 13, *reprinted in* 1980 U.S. CODE CONG. & AD NEWS 4696, 4707; *see* Heinlen, *supra* note 13, § 20.03[2][b] (discussing advantage of sales to related parties); Mylan, *supra* note 45, at 323-24 (same); Note, *supra* note 91, at 418-19 (same).

[94] 1980 S. REP., *supra* note 38, at 13, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4707. An additional advantage was that estate planning benefits accrued to the seller. Because the property after disposition was not includable in the seller's estate, any appreciation attributable to the property or to property acquired by the related party with the proceeds from the sale also escaped inclusion in the seller's estate. *Id., reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4707. Only the value of the uncollected installment obligation, which was frozen for estate tax purposes, was includable upon the seller's death. *Id., reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4707.

[95] *See* Coleman, *Intrafamily Installment Sales*, 180 N.Y.L.J. 1, 1-2 (1978) (discussing theories relied upon by the Service in related-party installment sales).

[96] *See, e.g.*, Nye v. United States, 407 F. Supp. 1345, 1349-50 (M.D.N.C. 1975) (wife, as original seller, did not control proceeds after subsequent sale by her husband to a third party); Wrenn v. Commissioner, 67 T.C. 576, 584 (1976) (Service refused to allow installment method where taxpayers failed to establish bona fide business purpose for

new Act embodies the first statutory attempt to delineate principles governing installment sales to related parties.[97] As an aid to understanding the tax advantages that the new Act seeks to proscribe, this comment initially considers the development of case law in the area, followed by an analysis of the legislation pertaining to related-party installment sales under the new Act.

1. Case Law

The Tax Court initially upheld the use of an irrevocable trust as an intermediary in a transaction involving the sale of stock of two closely-held corporations.[98] In *Rushing v. Commissioner*,[99] substantially all the assets of the two corporations had been exchanged for cash and notes pursuant to a section 337[100]

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the transaction).

[97] *See infra* notes 153-88 and accompanying text. Case law remains important for those related-party transactions falling outside the provisions of the new Act. Mylan, *supra* note 45, at 318; *see* 1980 S. Rep, *supra* note 38, at 17, *reprinted in* 1980 U.S. Code Cong. & Ad. News 4696, 4711-12 (Service's authority regarding sales to related parties not governed by amendment).

[98] Prior to 1969, attempts to obtain the benefits of the installment method while minimizing the risks inherent in deferred payment sales were primarily through the use of escrows and controlled corporations as intermediaries. *See, e.g.*, Griffiths v. Commissioner, 308 U.S. 355, 356-58 (1939) (newly-formed corporation treated as a sham); Hindes v. United States, 326 F.2d 150, 151-52 (5th Cir. 1964) (newly-formed corporation held to be a conduit); Williams v. United States, 219 F.2d 523, 527 (5th Cir. 1955) (seller was in constructive receipt of sales price by self-imposing an escrow); Pozzi v. Commissioner, 49 T.C. 119, 122-26 (1967) (seller insisted on payment in installments and escrow of certificates of deposit). More recently the Tax Court has upheld the use of an escrow in an installment sale. *See* Porterfield v. Commissioner, 73 T.C. 91, 95 (1979) (payments in escrow intended as security for promissory notes were not payments for § 453 purposes). *See generally* Comment, *Taxation: Use of Escrow Arrangements in Installment Sales*, 27 Okla. L. Rev. 543, 543-49 (1974) (escrow arrangements).

[99] 52 T.C. 888 (1969), *aff'd*, 441 F.2d 593 (5th Cir. 1971).

[100] 52 T.C. at 892. I.R.C. § 337(a) (1976) provides:

> If, within the 12-month period beginning on the date on which a corporation adopts a plan of complete liquidation, all the assets of the corporation are distributed in complete liquidation, less assets retained to meet claims, then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property within such 12-month period.

Prior to the enactment of § 337 in 1954, double taxation could result upon liquidation. A corporation that voted on a plan of liquidation and then sold its assets was required to recognize gain on the excess of amount realized over adjusted basis. I.R.C. § 1001(a) (1976). Upon distribution, the taxpayer was also required to report a gain on the excess between the liquidation proceeds and his adjusted stock basis. *Id.* In an effort to

plan of liquidation.[101] Prior to the expiration of the twelve month period allowed for corporate liquidations under section 337, the taxpayer, a fifty percent owner of the two corporations, created irrevocable trusts for the benefit of his children.[102] Thereafter, the taxpayer sold his stock in the corporations to the trusts for minimum cash down payments and twenty-year installment notes.[103] On the following day, the trustee approved the liquidation, and the proceeds, consisting mainly of installment notes received from the purchasers of the corporate assets, were distributed to the trusts.[104]

The Service contested the validity of the taxpayer's scheme to avail himself of installment reporting by arguing (1) that because the taxpayer and co-owner, as controlling shareholders and directors, had already elected to liquidate the corporations, they should be treated as having constructively received the proceeds from the resale,[105] and (2) that under the assignment of

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escape double taxation, taxpayers attempted first to liquidate their corporations, receiving a stepped-up basis, and then sell the assets individually. *See* Commissioner v. Court Holding Co., 2 T.C. 531 (1943) (sale must reflect economic reality to obtain the benefits of the installment sales provision), *rev'd*, 143 F.2d 823 (5th Cir. 1944), *rev'd*, 324 U.S. 331, 334-44 (1945).

[101] 52 T.C. at 892.

[102] *Id.* In a corporate liquidation, the corporation is, in effect, the purchaser. Thus, the notes received by the corporation upon the sale of its assets were evidences of indebtedness of a third party. Recall the rule discussed in *supra* note 66 that evidences of indebtedness of a third party will be considered as payments in the year of sale. As such, had the taxpayer received in the liquidation the notes of the third parties, he would not have qualified for installment reporting under the 30% initial payment limitation. *See supra* notes 45-69 and accompaying text. Moreover, § 331(a)(1) states, "[A]mounts distributed in complete liquidation of a corporation shall be treated as full payment in exchange for the stock." I.R.C. § 331(a)(1) (1976). Thus, without the benefit of the installment method, the taxpayer would have been taxed in the year of liquidation on the excess of the full value of the notes and other assets received over the adjusted basis of the stock. *See supra* notes 1-4 and accompanying text. Additionally, he would have received insufficient cash from the liquidation to pay the tax. Heinlen, *supra* note 13, § 20.03[2][a].

[103] 52 T.C. at 892.

[104] *Id.* at 892-93. Since the trusts obtained a stepped-up basis as a result of the purchase, the trusts' basis in the stock was equal to the anticipated distribution proceeds and no gain was recognized from the liquidation. Rushing v. Commissioner, 441 F.2d at 595. In addition the taxpayer elected to report his gain from the sale of the stock on the installment method, thereby deferring recognition of gain over the period payments were to be received. *Id.*

[105] 52 T.C. at 893.

income doctrine, the taxpayer intended to sell the corporations' assets, rather than the stock to the trusts.[106] In affirming the Tax Court's holding that the sale to the trusts qualified as an installment sale,[107] the Fifth Circuit Court of Appeals rejected both of the Commissioner's arguments.[108] The court rejected the assignment of income theory because the taxpayer had not attempted to recharacterize the gain or shift income to a taxable entity in a lower tax bracket.[109] In determining whether the taxpayer had achieved a result equivalent to receipt of the full sales proceeds, the court formulated the following two-prong test: "[I]n order to receive any installment benefits the seller may not directly or indirectly have control over the proceeds or possess economic benefits therefrom."[110] Applying the test, the court found that the taxpayer's only relationship to the trusts was that of a creditor.[111] The taxpayer had no control over the sales proceeds due to the independence of the trustees, and furthermore the taxpayer received no benefit from the total proceeds before all payments were made.[112]

Approximately four years after the *Rushing* decision, in *Nye v. United States*,[113] the district court upheld the use of an inter-

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[106] *Id.* at 896-97.

[107] *Id.* at 897-98.

[108] Rushing v. Commissioner, 441 F.2d at 597-98.

[109] *Id.* at 597.

[110] *Id.* at 598.

[111] *Id.*

[112] *Id.* Equitably, the court reached the proper conclusion in *Rushing*. *See* Note, *supra*, note 91, at 406-07 (supporting the result of the case only). Because of the reciprocal nature of § 331 and § 453, a taxpayer was unable to retain the tax benefits of the installment method when a corporation distributed installment notes in a liquidation. (The taxpayers' plight in these circumstances has now been alleviated by § 453(h). *See infra* notes 199-221 and accompanying text). Thus, the shareholder was required to recognize gain on the transaction before the proceeds were collected. This harsh consequence is exactly what § 453 was designed to alleviate. *See* Burnet v. S. & L. Bldg. Corp., 288 U.S. 406, 413-14 (1933); *supra* note 8 and accompanying text.

The case, however, is not without difficulty. The taxpayer did indirectly and practically control the trustee's decision to liquidate because the trustee would have had to forfeit the benefits of § 337 had he not completed liquidation within the statutory 12-month period for nonrecognition. *See* Eichenbaum, *Can Rushing Survive?*, 119 TRUSTS & ESTATES 27, 30 (1980) (analysis of *Rushing*). In resolving this problem, the court focused on the trustee's duty to the beneficiaries of the trust rather than requiring the grantor to prove that the trustee acted independently of the taxpayer. 441 F.2d at 598.

[113] 407 F. Supp. 1345 (M.D.N.C. 1975).

mediary in a noncorporate context.[114] In *Nye*, the wife agreed to assist her husband in raising funds for a business venture by selling securities to him under an installment arrangement.[115] The husband then resold the securities and collected the entire proceeds.[116] The court applied the test developed in *Rushing* and found the purpose of the transaction was to allow the husband to obtain funds at a four percent interest rate rather than at eight percent.[117] Thus, the court concluded that the wife ob-

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[114] *Id.* at 1350. Subsequent to the *Rushing* decision, the Service issued two revenue rulings regarding the use of intermediaries to obtain the benefits of installment sales reporting. Revenue Ruling 73-157 depicts two situations in which a seller arranged a sale to a third party and thereafter interjected an intermediary (a relative in the first instance, and a controlled corporation in the second) into the transaction to effectuate a resale of the property to the third party. Rev. Rul. 73-157, 1973-1 C.B. 213, 213. *See supra* note 92 and accompanying text. The seller in both cases was denied the use of § 453 on the ground that the intermediary served merely as a conduit to consummate the seller's transaction, and, thus, the resale lacked economic reality. *Id.* In the ruling, the Service emphasized the fact that prior to the sale to the intermediary, the taxpayers had negotiated the sale with the third party. *Id.* Revenue Ruling 73-536, however, indicated that the conclusion reached in ruling 73-157 was not premised solely on a determination that the transactions were prearranged and that the related parties were obligated to resell the property. Rev. Rul. 73-536, 1973-2 C.B. 158-59. The ruling concerned a wife who sold appreciated securities at fair market value to her husband. *Id.* at 158. The parties intended that the husband resell the securities to obtain the full sales proceeds. *Id.* at 158-59. Relying upon Revenue Ruling 73-157, the Service concluded that the understanding between the parties that the husband resell the securities was "strong evidence that the original sale lacked economic substance." *Id.* at 159; *see* Schnee, *Installment Sales: An Available Planning Device*, 57 TAXES 174, 176-77 (1979) (sale of property between spouses where there is an agreement to resell). As a result, the husband was presumed to have served merely as a conduit for his wife in consummating the sale. Rev. Rul. 73-536, 1973-2 C.B. 158, 159. The Service concluded that the combination of the marital relationship and the immediate resale by the acquiring spouse negated any claim the taxpayer might have regarding the economic substance of the transaction. *Id.* Revenue Ruling 73-536 conceded that in the proper circumstances the use of a related party as an intermediary may qualify for § 453 installment treatment if the transaction is "followed by a resale of the property to an unrelated third party." *Id.* "If such a transaction purporting to be an installment sale lacks reality, it will be no more effective in avoiding taxes than any other type of sale." *Id.* Unfortunately, the ruling did not describe the proper circumstances.

[115] 407 F. Supp. at 1347.

[116] *Id.*

[117] *Id.* at 1349-50. The Commissioner argued that the marital relationship of the parties caused the purchasing husband to become the agent of the seller-spouse. *Id.* at 1348. Additionally, under Revenue Rulings 73-157 and 73-536, the Commissioner contended that the wife's use of § 453 was precluded by their agreement that the husband would resell the securities. 407 F. Supp. at 1348-50. The court reasoned that the marital

tained no control over the resale proceeds or derived any benefit therefrom and permitted installment treatment of the interest intrastate sale.[118]

In *Wrenn v. Commissioner*,[119] the Tax Court reconsidered the conclusion reached in *Nye*. *Wrenn* involved an arrangement whereby the wife purchased stock on the installment basis from her husband and, pursuant to the original sales agreement, resold the stock to purchase mutual fund shares as security for the installment debt.[120] Although the court did not dispute the applicability of the *Rushing* control and economic benefit test,[121] it recognized that the validity of an intrafamily installment arrangement was contingent on the independence of the parties[122] and the presence of a substantive purpose for the transaction.[123] By imposing on the taxpayer the burden of establishing a bona fide motive for the intraspousal sale, the court denied installment treatment and held that the transaction was a sham.[124]

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relationship was not determinative of the agency or conduit issue since each spouse was economically independent of the other. *Id.* at 1349-50. Regarding the Service's second argument, the court determined that no prearranged plan existed between Mrs. Nye and the eventual purchasers, and that use of installment reporting cannot be denied simply because the original seller knew the installment purchaser planned to resell at some future date. *Id.* at 1350.

[118] *Id.* at 1349-50. See *Rushing v. Commissioner*, where the court stated:

> We think it clear from a reading of these cases that a taxpayer may, if he chooses, reap the tax advantages of the installment sales provision if he actually carried through an installment sale, even though this method was used at his insistence and was designed for the purpose of minimizing his tax.

441 F.2d at 598. *But see* Wrenn v. Commisssioner, 67 T.C. 576, 582 (1976) (indicating taxpayer must have substantive purpose other than minimizing his taxes). *See generally* Comment, *Federal Income Tax-Use of Installment Sale Reporting for Sales Between Related Taxpayers: The Separate v. Single Economic Entity Argument*, 54 N.C.L. Rev. 714, 717-20 (1976) (ability to use § 453 in intraspousal sales).

[119] 67 T.C. 576 (1976).

[120] *Id.* at 577-78.

[121] *Id.* at 581-87.

[122] *Id.* at 582. In addition, the court reasoned that intraspousal sales do not per se create an agency or conduit relationship, but they are subject to close scrutiny. *Id.* Furthermore, the court added that close scrutiny was necessary anytime the relationship of the parties affords the opportunity for tax avoidance. *Id.* at 584.

[123] *Id.* at 584; *see* Ruppert, *supra* note 91, at 52 n.9 (discussing Wrenn's allegations regarding the validity of the transaction).

[124] 67 T.C. at 584. *Nye* was distinguished by the court's finding in the earlier case that there was no prearranged sale and that the purchasing spouse entered into the transaction to obtain funding at a lower interest rate. *Id.* at 580-83; *see* Heinlen, *supra*

Following *Wrenn* the Tax Court in 1978 decided a series of four cases that expounded on the *Rushing* test when a related trust was used as an intermediary. In *Pityo v. Commissioner,*[125] the taxpayer had ninety percent of his assets in a low-yield publicly held stock.[126] Because economic necessity demanded that he obtain a higher return on his investment and a steady flow of income,[127] he sold his stock on the installment method to trusts established for his wife and children.[128] Thereafter, pursuant to the taxpayer's specific direction, the trustee resold the stock on the open market and invested the proceeds in mutual funds.[129] In upholding the installment election, the court again applied the *Rushing* test and reasoned that because the trustee was subject to the normal fiduciary responsibilities imposed by law, he was independent of the taxpayer.[130] Additionally, the court

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note 13, § 20.04[2][b][i]-[ii] (comparing *Nye* and *Wrenn*).

After the *Wrenn* decision was handed down, the Service issued Rev. Rul. 77-414, 1977-2 C.B. 299, and relied on *Wrenn* for support. The ruling involved a situation in which a taxpayer wished to sell the development rights to his property to a local county board and use § 453 to report the transaction. Because the local law prohibited the board from purchasing property on the installment method, the parties interposed a local bank to complete the transaction pursuant to a prearranged plan. *Id.* at 299-300. Citing the *Wrenn* case, the Service concluded the bank was an "unnecessary" party. *Id.* at 301. This reasoning goes beyond that evinced in both Revenue Ruling 73-157 and Revenue Ruling 73-536. *See supra* note 114. Clearly the taxpayer exercised no control over the bank, and, furthermore, the bank was free to invest the proceeds from the sale as it saw fit. The facts of the ruling indicate that the county chose the specific bank. Rev. Rul. 77-414, 1977-2 C.B. 299, 299. As a result, the bank actually served as the purchaser's agent rather than the taxpayer's agent, and the Service should have concluded the exchange between the taxpayer and the bank was an arm's length installment sale. *See* Ruppert, *supra* note 91, at 52 (discussing Revenue Ruling 77-414). One might determine from the Service's rationale in Revenue Ruling 77-414 that the use of an intermediary, regardless of the circumstances, is indicative of a sham.

[125] 70 T.C. 225 (1978). For a discussion of the remaining cases in this series, see *infra* note 131.

[126] *Id.* at 227.

[127] *Id.* The facts indicate the taxpayer was in debt, partially disabled, and unemployed. *Id.*

[128] *Id.* at 229-30. As a result of the taxpayer's declining financial position, his stockbroker suggested both the installment sale and the subsequent investment in mutual funds. *Id.* at 227.

[129] *Id.* at 228.

[130] *Id.* at 233-38; *see* Roberts v. Commissioner, 71 T.C. 311, 324 (1978) (upholding the installment election). The court in *Roberts* stated that if the intermediary is an independent entity, "[T]he fact that the [taxpayer] may have opted . . . to put the proceeds beyond his legal control does not vitiate . . . the transaction once it is consummated."

found that the second part of the test was satisfied because the taxpayer's ability to derive benefits from the proceeds of the sale was limited to receipt of the installment notes.[131]

More recently, in *Goodman v. Commissioner*,[132] the grantors formed trusts for their grandchildren and named their son and son-in-law as trustees.[133] Several years later the trustees made an installment sale to the trusts of an apartment complex that the trustees owned in their own names.[134] On the following day, in their capacity as trustees, the taxpayers resold the property to a third party.[135] The court refused to reconsider its position in *Rushing* and *Pityo* and concluded that a finding of independence on the trustees' part would be determinative of the case.[136] Looking to who controlled the proceeds and benefited

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Id. at 323. Also, the court indicated that the existence of a valid, independent trust was sufficient to withstand a substance over form attack. *Id.* at 322.

[131] 70 T.C. at 236-38. The second case in the series, Lustgarten v. Commissioner, 71 T.C. 303 (1978), involved an installment sale of stock by the taxpayer to his son. In accordance with an escrow agreement, the son resold the stock and invested the proceeds in mutual funds from which the installment payments were to be made. *Id.* at 305. The court determined that because the son was economically compelled to adhere to the escrow arrangement, the taxpayer had indirect control over the proceeds; thus, installment treatment was denied. *Id.* at 310-11.

Next in the series was Roberts v. Commissioner, 71 T.C. 311 (1978), which had facts nearly identical to *Pityo*, except that in *Roberts* the trustees of the intermediary trust were the taxpayer's brother and accountant. In analyzing the case, the court noted that the core of the *Rushing* test was to determine the independence of the intermediary. *Id.* at 322-23. Thereafter, based on a finding that the brother had actually influenced the taxpayer, and not vice versa, the court upheld the installment election. *Id.* at 324.

The last case involving the use of a related trust decided in 1978 was Weaver v. Commissioner, 71 T.C. 443 (1978). Under facts similar to *Rushing*, the interposition of the intermediary was sanctioned to allow the taxpayer to obtain the benefits of § 453 in a corporate liquidation. *Id.* at 452. The court noted that despite the existence of a prearranged plan to sell the corporation assets, the trustee's sole legal responsibility was to act independently in protecting the interests of the beneficiary, and he was not obligated to go forward with the sale. *Id.*

[132] 74 T.C. 684 (1981).

[133] *Id.* at 687.

[134] *Id.* at 690-91. The property was sold to the trust for $3,750,000, with a $100,000 downpayment and the remainder payable over a 20-year period at 6.65% interest. *Id.* at 691.

[135] *Id.* at 691-92. Upon resale by the trustees, the property was sold for $3,850,000, requiring a $600,000 downpayment and the balance payable over 25 years, together with 8% interest on the unpaid balance. *Id.*

[136] *Id.* at 701. The court stated, "The crucial fact is whether the trustee was acting solely as trustee and in the best interests of the trusts in making the purchase and sale of

therefrom,[137] the court found that the trust instruments permitted self-dealing and that the trustees had acted in good faith and in the best interests of the trust beneficiaries.[138] Thus, the trusts were held to be independent and the installment election was permitted.

In summary, under the state of the law prior to passage of the Act,[139] the original seller must not have exercised any control over the sales proceeds, directly or indirectly, and must not have obtained any economic benefit therefrom.[140] Second, the intermediary must have been interposed into the transaction for a purpose other than mere tax deferral.[141] Third, the intermediary, whether a trust or other related party, must have been independent of and not controlled by the seller.[142] Finally, as little negotiation as possible should have transpired between the original seller and the ultimate purchaser, and the intermediary must have performed some affirmative act to finalize the sale or liquidation, or must have possessed the power to terminate it.[143]

A major problem that becomes apparent from the foregoing cases is that the equity that supported the *Rushing* decision[144] is lacking in the noncorporate cases following *Rushing*. In the later cases, the taxpayers voluntarily restricted their rights to the full proceeds to gain the benefits of section 453.[145] Congress enacted

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the property." *Id.* at 709.

[137] *Id.* at 704-06.

[138] *Id.* at 709.

[139] *See* Eichenbaum, *supra* note 112, at 33-34.

[140] *See supra* note 110 and accompanying text.

[141] *Compare* Nye v. United States, 407 F. Supp. 1345, 1349-50 (M.D.N.C. 1975) (purpose was to obtain funding at low interst rate) *with* Wrenn v. United States, 67 T.C. 576, 582 (1978) (no substantive purpose other than minimizing tax).

[142] *See* Nye v. United States, 407 F. Supp. 1345, 1347-48 (M.D.N.C. 1975) (husband and wife maintained substantial separate estates); Roberts v. Commissioner, 71 T.C. 311, 322 (1978) (existence of valid, independent trust was sufficient to withstand a substance over form attack); Pityo v. Commissioner, 70 T.C. 225, 233-34 (1978) (trustee independent of the taxpayer).

[143] *See* Nye v. United States, 407 F.Supp. 1345, 1350 (M.D.N.C. 1975) (prearranged plan argument only makes sense when a party makes use of a strawman as a conduit between the first and third parties); Weaver v. Commissioner, 71 T.C. 443, 452 (1978) (despite prearranged sale, trustee's legal responsibility was to beneficiaries).

[144] *See supra* note 112.

[145] *See* Weaver v. Commissioner, 71 T.C. 443, 445-48 (interposition of third party for deferred recognition purposes); Roberts v. Commissioner, 71 T.C. 311, 312-13 (same);

the installment provision to prevent liquidity problems to taxpayers who might otherwise be forced to pay taxes currently on sales from which the proceeds are not due.[146] The Tax Court, however, has allowed the provision to become a scheme for tax avoidance by allowing the realization of appreciation within a related group without the current payment of income tax.[147] Moreover, a family unit has been afforded the opportunity to receive the highest return on the investment by using the funds that resulted from the tax deferral.[148] Illustrative of this technique is *Pityo v. Commissioner*,[149] where the grantor expected to receive the entire sales proceeds together with the minimum in-

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Pityo v. Commissioner, 70 T.C. 225, 230 (same); *see also* Commissioner v. Court Holding Co., 324 U.S. 331, 334 (1945) (discussing economic substance). The Supreme Court, in *Court Holding Co.*, stated:

> [T]he incidence of taxation depends upon the substance of a transaction. The tax consequences which arise from gains from sale of property are not finally to be determined solely by the means to transfer legal title. Rather, the transaction must be viewed as a whole and each step, from the commencement of negotiations to the consummation of the sale, is relevant. A sale by one person cannot be transformed for tax purposes into a sale by another by using the latter as a conduit through which to pass title. To permit the true nature of a transaction to be disguised by mere formalisms, which exist solely to alter tax liabilities, would seriously impair the effective administration of the tax policies of Congress.

Id.

[146] *See supra* note 8 and accompanying text.

[147] The Senate report states as follows:

> The committee appreciates the fact that denial of installment sale treatment may be harsh for a shareholder who receives liquidating distributions of the installment obligations received by the corporation from the sale of its assets. In that case, the shareholder may incur a substantial tax on the gain from the stock without having received current funds from the corporate liquidation with which to pay the tax. Accordingly, the committee's bill, as later described, includes a provision to deal with that potential hardship. However, the committee believes that the application of the judicial decisions, involving corporate liquidations, to intra-family transfers of appreciated property has led to unwarranted tax avoidance by allowing the realization of appreciation within a related group without the current payment of income tax.

1980 S. REP., *supra* note 38, at 14, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4708-09.

[148] *See* Heinlen, *supra* note 13, § 20.03[2][b] (discussing advantage of sales to related parties); Mylan, *supra* note 45, at 323-24 (1981) (same); Note, *supra* note 91, at 418 (same).

[149] 70 T.C. 225 (1978).

terest allowable.[150] On the other side of the transaction, the grantor was able to establish trusts for his children with more than the contract balance remaining in trusts at the end of the payment period.[151]

2. Analysis of Transactions Involving Second Dispositions by Related Persons

As a result of these recent successes in Tax Court, Congress has recognized the need to amend section 453.[152] The primary attack on related parties is found in section 453(e), which provides for early recognition of gain by the initial seller if a resale occurs by the related intermediary within two years of the original sale.[153] Congress's underlying motive in this amendment was to prevent the retention of the proceeds from a resale within the related group without the current payment of tax.[154] For purposes of this rule, a related party is a person whose stock would be attributed to the initial seller of the property under section 318(a).[155] Thus, regarding family members, the term encompasses the taxpayer's spouse, children, grandchildren, and parents, but does not extend to his brothers and sisters.[156] Furthermore, the principles of section 318(a) apply to partnerships, estates, trusts, and corporations.[157]

If a second disposition occurs, the amount deemed to be received by the original seller is the lesser of the amount realized from the second disposition or the contract price from the first disposition, minus the aggregate of all payments received from the first sale before the close of the taxable year, including those payments received in prior years.[158] Thus, acceleration of gain

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[150] *Id.* at 234.

[151] *Id.*

[152] *See supra* note 147 and accompanying text.

[153] I.R.C. § 453(e) (West Supp. 1981). The statutory two-year period does not apply to marketable securities. *Id.* § 453(e)(2).

[154] 1980 S. REP., *supra* note 38, at 14, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4708-09; *see supra* notes 147-48 and accompanying text.

[155] I.R.C. § 453(f)(1) (West Supp. 1981).

[156] *Id.* § 318(a)(1) (1976).

[157] *Id.* § 318(a); 1980 S. REP., *supra* note 38, at 14, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4711; H.R. REP., *supra* note 38, at 14.

[158] I.R.C. § 453(e)(3) (West Supp. 1981).

will result to the extent the amount realized from the second disposition exceeds the actual payments received on the initial installment obligation.[159]

The following illustration should be helpful in demonstrating the application of section 453(e). Assume that *X* sells land to his son, *Y*, for $600,000 in 1981. The land had been held as an investment for several years and had a basis to *X* of $300,000. *Y* made a downpayment of $100,000 and agreed to pay installments of $50,000 a year, together with interest at 12% per annum on the unpaid balance. Early in the following year, *Y* paid $50,000 plus the applicable interest to *X*, and thereafter resold the property to *Z*, an unrelated party, for $800,000. The amount treated as received by *X* as a result of *Y*'s resale in 1982 will be determined as follows:

1.	Total amount realized from disposition to *Z*:	$800,000
2.	Total contract price on sale to *Y*:	$600,000
3.	Lesser of 1 or 2:	$600,000
4.	Sum of payments received by *X* before the end of the resale year [(1981) $100,000 + (1982) $50,000]:	$150,000
5.	Amount realized by *X* on resale (step 3 - step 4)	$450,000

To continue this example, steps 6 and 7 will compute the amount of gain to be recognized by *X* from each disposition:

6. Gain to be recognized by *X* in 1981 from sale to *Y*:

$$\text{Gross Profit Ratio: } \frac{\$600{,}000 - \$300{,}000}{\$600{,}000} = \frac{1}{2} = 50\%$$

$$50\% \times \$100{,}000 = \$\ 50{,}000$$

7. (a) Gain to be recognized by *X* in 1982 on disposition to *Z*:

$$50\% \times \$450{,}000 = \$225{,}000$$

(b) Gain to recognized to *X* in 1982 from payments by *Y*:

$$50\% \times \$50{,}000 = \$\ 25{,}000$$

Total gain recognized by *X* (step 6 + step 7): $300,000

Pursuant to section 453(e)(5), payments received in subsequent taxable years by the initial seller will be recovered tax-free until

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[159] The assumption here is that the amount realized on the second disposition is equal to or less than the contract price.

they equal the amount received from the resale that resulted in the acceleration of gain.[160] Thus, in the above example, because the remaining installment obligations to *X* total $450,000, and the amount *X* treated as received from the resale equals $450,000, all future principal payments will be received tax-free by *X*.

The two-year cut-off period within which the resale must occur for the acceleration rules to become operative is not as generous as it may appear. In the case of a resale of marketable securities[161] by a related party, the recognition rules of section 453(e) will be triggered regardless of when the sale occurs.[162] For property other than marketable securities, the running of the two-year period is suspended for any period during which the related party's risk of loss with respect to the property is substantially diminished.[163] Furthermore, the rule specifically states that the holding of a put or option to sell the property, the holding by another person of a right to acquire the property, or a short sale will suspend the running of the two-year period.[164]

The Act provides four exceptions to the operation of the acceleration rules on resale by a related party.[165] First, there is no acceleration where a corporation resells treasury stock subsequent to its reacquisition in exchange for installment notes.[166] The exception indicates that a sale or exchange of stock to the

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[160] I.R.C. § 453(e)(5) (West Supp. 1981).

[161] Section 453(f)(2) defines marketable security as "any security for which, as of the date of the disposition, there was a market on an established securities market or otherwise." I.R.C. § 453(f)(2) (West Supp. 1981). The Senate report has a similar definition and states that mutual fund shares for which redemption prices are published will also be considered marketable securities. 1980 S. REP., *supra* note 38, at 15 n.20, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4710.

[162] I.R.C. § 453(e)(1), (e)(2)(A) (West Supp. 1981). Of course, once the installment notes have been paid, there will be no remaining unrecognized gain to be accelerated by the rule.

[163] *Id.* § 453(e)(2)(B).

[164] *Id.* For purposes of the suspension rule, a typical close corporation shareholders' agreement is not taken into account, and the holding of an option will not have the effect of substantially diminishing the risk of loss of the option price as determined by the fair market value of the property when the option is exercised. 1980 S. REP., *supra* note 38, at 15, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4710; H.R. REP., *supra* note 38, at 13.

[165] I.R.C. § 453(e)(6)-(7) (West Supp. 1981).

[166] *Id.* § 453(e)(6)(A).

issuing corporation shall not be treated as a first disposition.[167] Because the gain from the sale of a corporation's treasury stock is nontaxable, Congress reasoned that the basis in the stock is irrelevant.[168] Second, a related-party purchaser's disposition of property in an involuntary conversion within the meaning of section 1033 and any transfer thereafter shall not be treated as a second disposition if the first sale occurred before the threat or imminence of the conversion.[169] Third, no acceleration results if the second sale occurred after the death of either the installment seller or the related purchaser.[170] Finally, the resale rules are not applicable to a second disposition if the taxpayer establishes to the satisfaction of the Internal Revenue Service that neither the first nor the second disposition had as one of its primary objectives the avoidance of federal income tax.[171] Both the House and Senate committees contemplated that this nontax avoidance exception would apply to certain tax-free exchanges—such as charitable transfers,[172] like-kind exchanges, gift transfers, and transfers to controlled corporations or partnerships[173]—that should not be treated as second dispositions. Additionally, the committees anticipated that a second disposition would qualify if it were an involuntary transfer, other than an involuntary conversion,[174] such as foreclosure or bankruptcy where the related purchaser is forced to sell the property.[175] Another exception would apply to a subsequent sale of the property by the related

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[167] *Id.*

[168] 1980 S. REP., *supra* note 38, at 15, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4710.

[169] I.R.C. § 453(e)(6)(B) (West Supp. 1981).

[170] *Id.* § 453(e)(6)(C). Generally, this exception will apply after the death of either spouse when the spouses hold their interests in the installment obligation or the purchased property as community property or as equal undivided interests. 1980 S. REP., *supra* note 38, at 15-16, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4710.

[171] I.R.C. § 453(e)(7) (West Supp. 1981).

[172] *See* Heinlen, *supra* note 13, § 20.04[1][a] (discussing prior case law on second dispositions to charities).

[173] 1980 S. REP., *supra* note 38, at 16, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4710; H.R. REP., *supra* note 38, at 14.

[174] 1980 S. REP., *supra* note 38, at 16, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4710; H.R. REP., *supra* note 38, at 14.

[175] 1980 S. REP., *supra* note 38, at 16, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4710; H.R. REP., *supra* note 38, at 14.

purchaser under an installment agreement having terms of payment essentially equivalent to the terms of the original installment contract.[176]

Several Congressmen and private practitioners expressed concern over the language of the fourth exception.[177] Requiring the taxpayer to satisfy the Service that one of the principle purposes of the transaction is not tax avoidance may hinder a court's decision on the merits.[178] In response, the Senate Finance Committee stated in its report that "in determining the question of tax avoidance, the Commissioner shall treat taxpayers fairly and equitably in light of all the facts and circumstances of each particular case in a manner consistent with the remedial intent of the [related-party rules]."[179] Further, to ensure that the rules are properly applied, the Commissioner is required to report annually to the appropriate congressional committees, and the General Accounting Office must report to Congress not later than two years after the enactment of the legislation, on the manner in which the amended sections are being applied.[180] The Senate Finance Committee itself will monitor the administration of the Act.[181]

Although the amendment of section 453 has severely restricted the taxpayer's ability to obtain tax deferral while simultaneously benefiting from the appreciation of property within the family unit, the *Rushing* trust remains an important tool in

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[176] 1980 S. REP., *supra* note 38, at 16, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4711; H.R. REP., *supra* note 38, at 14. The exception, however, would not apply if the resale terms would permit significant deferral of recognition of gain from the initial sale when proceeds from the resale are being collected sooner. 1980 S. REP., *supra* note 38, at 16, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4711; H.R. REP., *supra* note 38, at 14. The Secretary of the Treasury is authorized to issue regulations requiring the initial seller to notify the Service of any subsequent disposition that "may" trigger the acceleration rules. I.R.C. § 453(e)(8) (West Supp. 1981). In order to further assist the Service in enforcing the resale acceleration rules, the period for assessing deficiencies extends until two years after notice of resale is given to the Service. *Id.*

[177] 1980 S. REP., *supra* note 38, at 17-18, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4712.

[178] *See id.*, 1980 U.S. CODE CONG. & AD. NEWS 4696, 4712 (committee believes taxpayers should have equal footing in court contests).

[179] *Id.* at 18, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4712.

[180] *Id., reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4712.

[181] *Id., reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4712.

future tax planning. One loophole exists where property other than marketable securities is transferred to a family trust and the independent trustee waits out the statutory two-year period before reselling the property.[182] This may be a viable option where a trust has assets capable of producing a high yield. The trustee should be able to pay the installment obligation with the trust income during the period before a buyer is found.[183] Payments on the note would provide the grantor with retirement income while the trust would gain appreciation on the assets. Another technique that should permit qualification for installment treatment results from the exclusion of brother-sister relationships in the definition of related persons for purposes of section 453(e).[184] Where a brother or sister is unable to care for

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[182] *See* Eichenbaum, *supra* note 112, at 38 (pitfalls encountered under § 453 by resale after the two-year period).

[183] Although this arrangement seems simple enough, several obstacles must be overcome. First, intermediary trusts are often afterthoughts to a prearranged sale. *Id.* In most cases, the terms of the sale have been developed and agreed upon by buyer and seller, and, in a quickly devised tax deferral scheme, the related party is used to restructure the transaction and complete the sale. *Id.* The buyer may be unwilling, however, to wait two years to enable the seller to use installment reporting. As an incentive to encourage the buyer to postpone the consummation of the transaction, the seller could offer a bargain sale. As a result, additional problems would arise. The trustee would obviously be reluctant to proceed with a bargain sale if he knew the property could obtain a higher selling price. *See* Weaver v. Commissioner, 71 T.C. 443, 453 (1978) (trustee's legal responsibility was to beneficiaries). Carrying through with such a sale would be wrongful against the beneficiaries and would tend to indicate that the trust was merely a conduit to carry out the desires of the seller. *See id.* (primary trust objective was appreciation). Furthermore, the two-year period may be suspended since the related party's risk of ownership is substantially diminished by the buyer's prearranged right to acquire the property. I.R.C. § 453(e)(2)(B) (West Supp. 1981). Obviously, this would be the case where the taxpayer had negotiated the resale to the third party; but, where the related party and the purchaser alone contracted for a resale at the end of the two-year period, the result would be uncertain. Eichenbaum, *supra* note 112, at 38.

A second problem that might result from allowing the statutory period to run is that the trust assets may appreciate before resale and some gain will have to be recognized by the trust. Because the assets initially sold to the trust would result in an inherently high gain and correspondingly large tax liability to the grantor, his deferral would likely offset any tax on the trust's subsequent resale of the property. In these circumstances, a bargain sale to the trust would probably be advisable to decrease the taxpayer's liability and to leave more in trust for the beneficiaries. *Id.*

[184] 1980 S. REP., *supra* note 38, at 16, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4711; H.R. REP., *supra* note 38, at 14; *see* I.R.C. § 318(a) (1976) (attribution rules). In view of Congress's expressed intention in the Act to prohibit appreciation in a family unit without the current recognition of gain, such a transaction would be subject

himself or herself, or is under guardianship, the other siblings could establish a trust for the related party's benefit. Because the trustee or guardian is legally required to act in the best interests of the beneficiary, property sold to the trustee or guardian on the installment method may be resold to purchase other property that may, in the judgment of the trustee or guardian, yield a higher return.[185] Again, the grantor will benefit by the deferral of income recognition and the receipt of installment payments, and the related party will gain the appreciation of the property. A third alternative that will accomplish a result similar to that of the *Rushing* trust involves the use of a private annuity.[186] The taxpayer could structure an arrangement whereby he sells his property to a trust or other related party in exchange for a life annuity.[187] Deferral of income would be obtained under section 72, which excludes income upon receipt of annuity payments based on the ratio of the investment in the contract to the expected return.[188] The family unit can thereafter resell the property and receive the entire proceeds from the sale.

F. Sales of Depreciable Property Between Related Parties

Another area in which Congress sought to deter taxpayer abuse is that of installment sales of depreciable property between related parties.[189] Under a deferred payment sale of this nature, a related purchaser was able to gain the benefit of depreciation deductions measured from a stepped-up basis prior to the time the seller was required to include in income the corre-

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to scrutiny by the Service. *See* H.R. REP., *supra* note 38, at 14. Arguments could be raised by the Commissioner based on assignment of income, agency/conduit principle, constructive receipt, or substance over form. *See supra* notes 105-06 and accompanying text (discussing the Service's contentions in *Rushing*).

[185] *See* Goodman v. Commissioner, 74 T.C. at 702-08.

[186] *See* 1980 S. REP., *supra* note 38, at 12 n.12, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4707 (bill does not deal directly with "private annuity" arrangements); Ginsburg, *Future Payment Sales After the 1980 Revision Act*, 39 INST. ON FED. TAX'N §43.09 (1981) (private annuities).

[187] *See* Eichenbaum, *supra* note 112, at 38-39 (private annuity arrangement).

[188] I.R.C. § 72(b) (1976).

[189] *Id.* § 453(g) (West Supp. 1981).

sponding gain on the sale.[190] In response, Congress enacted section 453(g), which denies the use of installment reporting for sales of depreciable property between certain related parties.[191] Thus, the seller is required to report the fair market value of installment obligations as an amount realized in the year of sale.[192] In effect, the amendment calls for accrual reporting of the transaction. For purposes of section 453(g), the term "related persons" is equivalent to the class described in section 1239(b).[193] The class includes (1) the taxpayer and the taxpayer's spouse, (2) the taxpayer and a partnership or corporation, eighty percent or more of which is owned by the taxpayer, directly or indirectly, and (3) any two such eighty percent owned corporations or partnerships.[194]

As with the exception to the acceleration rules of section 453(e), the rules on sales of depreciable property between related parties will not apply if the taxpayer satisfies the Service that the exchange was not consummated for the purpose of avoiding federal income tax.[195] The committee reports state that if an installment sale occurs between a husband and wife who are legally separated under a divorce decree or separate maintenance agreement at the time of the sale, section 453(g) will not apply.[196] The rule will also be inapplicable if the installment sale

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[190] 1980 S. REP., *supra* note 38, at 17, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4711.

[191] I.R.C. § 453(g) (West Supp. 1981).

[192] *Id.* § 453(g)(1).

[193] *Id.*

[194] *Id.* § 1239(b)-(c). Section 1239(a) of the Code provides that in the case of a sale or exchange of depreciable property between related persons, any gain recognized by the transferor shall be treated as ordinary income and not as capital gain. *Id.* § 1239(a) (Supp. II 1978). Congress reasoned that the definition of related persons for purposes of § 1239 should be the same as the definition of related persons under the special rule denying installment treatment to sales of depreciable property between related parties. 1980 S. REP., *supra* note 38, at 28, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4723. Thus, § 453(g)(1) coordinates its definition to that of § 1239(b) by referring to § 1239(b) in describing related parties. I.R.C. § 453(g)(1) (West Supp. 1981). The Act amended the § 1239(b) definition of related persons by (1) adding an 80% owned partnership to such definition, *id.* §1239(c)(1)(B), and (2) providing that the family attribution rules of § 318(a)(1) will apply only with respect to spouses and not children, grandchildren, or parents, *id.* § 1239(c)(2)(A).

[195] I.R.C. § 453(g)(2) (West Supp. 1981).

[196] 1980 S. REP., *supra* note 38, at 17, *reprinted in* 1980 U.S. CODE CONG. & AD.

occurs pursuant to a settlement in a proceeding that culminates in a decree of divorce or separate maintenance.[197] Further, section 453(g) will not deny installment reporting if no significant tax deferral benefits will be derived from the sale.[198]

G. Installment Treatment of Distributions in Corporate Liquidations Under Section 337

In section 453(h), Congress made major changes that expand installment coverage when deferred payment obligations are distributed in corporate liquidations.[199] As noted previously, the *Rushing* trust was initially designed because shareholders could not avail themselves of installment reporting when deferred payment notes from a corporate sale of assets were distributed pursuant to a section 337 liquidation.[200] To avoid this situation, the shareholder in *Rushing* structured the sale whereby a related trust purchased his stock under section 453, and the trustee subsequently completed the liquidation, receiving in the distribution installment notes owed to the corporation by a third party.[201] Except for the estate planning advantages that can be obtained by a *Rushing* trust,[202] section 453(h) now achieves basically the same deferred recognition derived by the shareholder in *Rushing*. The Act provides that if a corporation adopts a plan of liquidation pursuant to section 337 and receives installment obligations from a sale of its assets under the plan, the subsequent distribution of the notes to a shareholder will not cause recognition of gain under section 331.[203] While under prior law the shareholder was required to report the fair market value of the installment note distributed as an amount received

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NEWS 4696, 4712; H.R. REP., *supra* note 38, at 15.

[197] 1980 S. REP., *supra* note 38, at 17, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4712; H.R. REP., *supra* note 38, at 15.

[198] 1980 S. REP., *supra* note 38, at 17, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4712; H.R. REP., *supra* note 38, at 15.

[199] I.R.C. §453(h) (West Supp. 1981).

[200] *See supra* notes 102, 112 and accompanying text.

[201] *See supra* notes 99-104 and accompanying text.

[202] *See* Heinlen, *supra* note 13, § 20.03[2][b] (discussing advantages of related party transactions).

[203] I.R.C. § 453(h)(1)(A) (West Supp. 1981).

in payment for his stock,[204] under the Act, the shareholder treats payments received on the note as receipt of payment on the installment basis for his stock.[205] Thus, the shareholder is entitled to report the gain realized on the liquidation ratably as payments on the installment obligations are received.[206] Deferred recognition, however, is not available to the extent that installment notes received by the corporation are attributable to sales of inventory, except where substantially all the inventory is sold to one individual in a bulk sale.[207]

Previously, distributions paid in installments extending over more than one taxable year of the shareholder were first applied against the shareholder's basis in the stock.[208] Gain was only recognized when and to the extent the liquidating distributions exceeded the shareholder's basis.[209] Currently, this favorable cost recovery treatment is denied where a shareholder receives a liquidating distribution in more than one taxable year, and the property received consists at least in part of installment obligations initially received tax-free by the corporation pursuant to section 337.[210] Any distributions made to the shareholder in the

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[204] *See supra* note 102 and accompanying text.

[205] I.R.C. § 453(h)(1)(A) (West Supp. 1981).

[206] *Id.* Installment reporting is also available to shareholders of a liquidating parent corporation with respect to installment obligations first received by a liquidating subsidiary corporation in asset sales that were nontaxable pursuant to § 337(c)(3). *Id* § 453(h)(1)(E). For a demonstration of the computation of gain when the installment obligations are distributed in the first taxable year of the shareholder, see example 1 following text at *infra* note 212.

[207] I.R.C. § 453(h)(1)(B) (West Supp. 1981).

[208] *See* Mattison v. United States, 273 F.2d 13, 17 (9th Cir. 1959).

[209] *Id.* An established exception to the general rule is given effect, however, when a taxpayer who is interested primarily in the corporation's assets first purchases the stock and then liquidates the corporation in order to acquire the desired assets. In this situation, the separate steps taken to accomplish the taxpayer's primary objective will be treated as a single transaction, the substance of the transaction being a purchase of property rather than a purchase of stock. *Id.* The court in *Mattison* applied the exception and concluded that an allocation of the taxpayer's stock basis should be applied to the liquidating distributions if reasonably possible. *Id.* at 21-22.

[210] I.R.C. § 453(h)(2) (West Supp. 1981). For a demonstration of the computation of gain when the property is distributed in more than one taxable year of the shareholder, see example 2 following text at *infra* note 213. Although the Installment Sales Revision Act of 1980, *supra* note 21, uses the language "more than one taxable year," liquidating distributions in a § 337 liquidation must fall within a 12-month period and, therefore, cannot extend beyond two taxable years of the shareholder. I.R.C. § 337(a) (1976).

taxable year prior to completion of the liquidation are treated by the shareholder as if the cost recovery method were applicable.[211] In the following year, upon completion of the liquidation, the shareholder is required to file an amended return for the previous year to reallocate his basis in the stock of the corporation among all property received by the shareholder in the liquidation.[212]

The following two examples will help to illustrate the operation of section 453(h).

Example 1: Assume that *X* is a calendar year taxpayer and is the sole shareholder of *XYZ* corportaion. *X* has an adjusted basis in the stock of $300,000. Assume further that the corporation adopts a complete plan of liquidation on January 1, 1982, and sells all of its assets at the end of the month to *A*, an unrelated purchaser, for $600,000, consisting of $100,000 in cash and an installment note for $500,000, payable $100,000 a year for five years. Also assume that the sale qualifies for nonrecognition of gain to the corporation pursuant to section 337 and that there is no imputed interest or original issue discount. *XYZ* corporation distributes the cash and installment obligation in June.

X would compute his gain in 1982 and thereafter as follows:

1. Allocation of stock basis between cash and note received:

   (a) $\frac{\text{cash}}{\text{total distribution}} = \frac{\$100{,}000}{\$600{,}000} = \frac{1}{6} \times \$300{,}000 = \$\ 50{,}000$

   (b) $\frac{\text{face amount of note}}{\text{total distribution}} = \frac{\$500{,}000}{\$600{,}000} = \frac{5}{6} \times \$300{,}000 = \$250{,}000$

2. Gain reported in 1982:
   $100,000 (total cash received) minus
   $50,000 (pro rata stock basis allocated to cash distribution) = $ 50,000

3. Gain to be reported upon receipt of payments on the note:

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[211] *See supra* notes 208-09 and accompanying text.

[212] I.R.C. § 453(h)(2) (West Supp. 1981); 1980 S. REP., *supra* note 38, at 21, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4716.

(a) Gross Profit Ratio = $\frac{\text{face amount of note minus stock basis allocable to note}}{\text{contract price}}$ [213]

$$\frac{\$500,000 - \$250,000}{\$500,000} = \frac{\$250,000}{\$500,000} = 50\%$$

(b) Gross profit ratio multiplied times payment received in the taxable year to give reported gain:
50% x $100,000 = $ 50,000

In the first year $50,000 will be reported on the transaction. Under 3., $50,000 will be reported in each of the following five years. Thus, the total gain reported will be $300,000.

Example 2: Assume similar facts, except *X*'s adjusted stock basis is $60,000. Additionally, assume the plan of liquidation was adopted later in the year, the cash was distributed in 1982, and the note was distributed in 1983. Computation of gain to be reported by *X* will be as follows:

1. Gain originally reported in 1982:
$100,000 (cash received) minus $60,000 (adjusted stock basis) = $ 40,000

Upon distribution of the note in 1983, *X* is required to recompute the gain in 1982 by allocating basis as in Example 1 according to the installment sales rules.

2. Allocation of stock basis between cash and note received:
(a) $\frac{\text{cash}}{\text{total distribution}} = \frac{\$100,000}{\$600,000} = \frac{1}{6}$ x $60,000 = $ 10,000
(b) $\frac{\text{face amount of note}}{\text{total distribution}} = \frac{\$500,000}{\$600,000} = \frac{5}{6}$ x $60,000 = $ 50,000

3. Gain, as amended for 1982:
$100,000 (cash received) - [the sum of $10,000 (stock basis allocable to cash) and $40,000 (gain previously recognized)] = $ 50,000

4. Gain to be reported upon receipt of payments on the note:

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[213] The cash deposit is not considered part of the contract price for purposes of computing the gross profit ratio because a portion of the stock basis has been allocated to the cash distribution in computing the gain.

(a) Gross Profit Ratio = $\frac{\text{face amount of note minus stock basis allocable to note}}{\text{contract price}}$ [214]

$$\frac{\$500{,}000 - \$50{,}000}{\$500{,}000} = \frac{\$450{,}000}{\$500{,}000} = 90\%$$

(b) Gross profit ratio multiplied times payment received in the taxable year to give reported gain:

90% x $100,000 = $90,000

In the first year a total of $90,000 will be reported on the transaction. Under 4., an additional $90,000 will be reported in each of the following five years. Thus, the total gain reported will be $540,000.

Not all distributions of installment notes in a corporate liquidation under section 337 will qualify for deferral of gain until payments are received. Obligations generated by sales of property preceding the adoption of a plan of liquidation are outside the scope of section 453(h).[215] Furthermore, if the installment purchaser and the shareholder are related parties within the meaning of section 1239(b), installment reporting will be unavailable to the extent the installment obligation is attributable to the disposition by the corporation of depreciable property.[216] Payments on the notes will be deemed received in the year the obligation is distributed to the shareholder.[217] Another restriction on the application of the deferral provision of section 453(h) results from its interaction with section 453(e).[218] Thus, if a per-

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[214] *See supra* note 213.

[215] I.R.C. § 453(h)(1)(A) (West Supp. 1981). The section states that it is applicable to an installment obligation acquired in respect "of a sale or exchange by the corporation during the 12-month period set forth in section 337(a)." *Id.*

[216] *Id.* § 453(h)(1)(C).

[217] *Id.*

[218] *Id.* § 453(h)(1)(C)(ii). Section 453(h)(1)(C) applies the same rule that denies installment reporting in the context of shareholders who receive installment obligations in a liquidating distribution that § 453(g)(1) applies to related-party sales of depreciable property. Mylan, *supra* note 45, at 336 n.157. The sections, however, operate independently of each other. *Id.* Thus, there is some uncertainty whether the exception for non-tax avoidance transactions of § 453(g)(2) will extend to related-party sales covered by § 453(h)(1)(C). Statements by Senator Long provide clarification indicating that Congress did in fact intend the exception to apply to § 453(h)(1)(C) sales that are not principally motivated by tax avoidance purposes. 126 CONG. REC. S16,536-37 (daily ed. Dec. 13, 1980) (statement of Sen. Long).

son related to a shareholder under the attribution rules of section 318(a) purchases the corporation's assets under an installment agreement, a subsequent disposition of those assets within the statutory period will cause an acceleration of gain to be recognized by the shareholder.[219]

The policy motivating the enactment of section 337 was that a sale at the corporate level followed by a distribution of proceeds should receive essentially the equivalent tax treatment as a sale by a shareholder subsequent to a distribution of the assets to him.[220] Section 453(h), which allows installment reporting regardless of whether the obligation arose from a direct sale of assets at the corporate level or a sale by shareholders, carries forward the policy of having the tax consequences turn on the substance rather than the form of the transaction. Thus, Congress has eliminated the hardship that could be caused when a shareholder incurred a substantial gain upon corporate liquidation from distribution of an installment obligation without the receipt of cash to pay the tax.[221]

H. Treatment of Third-Party Guarantees

Presently, controversy has arisen regarding the proper treatment of third-party guarantees that are used as security for deferred payment obligations. In *Griffith v. Commissioner*,[222] a standby letter of credit was used to secure future payment for the sale of a cotton crop.[223] The Tax Court ruled that because of the letter of credit, the taxpayer had obtained the economic benefit of the sales proceeds and so could not use the installment method.[224] Less than six months later, the Tenth Circuit Court

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[219] I.R.C. § 453(h)(1)(D) (West Supp. 1981). The Senate report states the rule should apply only to related parties not covered by the special rule of § 453(h)(1)(C). 1980 S. Rep., *supra* note 38, at 22, *reprinted in* 1980 U.S. Code Cong. & Ad. News 4696, 4717.

[220] *See* B. Bittker & J. Eustice, Federal Income Taxation of Corporations and Shareholders 11-64 to -69 (4th ed. 1979) (problems encountered in liquidation prior to the enactment of §337).

[221] *See supra* note 112.

[222] 73 T.C. 933 (1980).

[223] *Id.* at 935.

[224] *Id.* at 942. The court made an extensive analysis of its reasoning, but primarily relied on the line of cases that used an escrow arrangement to minimize default on the

of Appeals reached a contrary conclusion based on similar facts. In *Sprague v. United States*,[225] the court of appeals held that a letter of credit used to secure payment for the sale of stock did not constitute payment for purposes of the installment sales provisions.[226] As a result of these conflicting cases, the Senate made a last minute change in the bill to provide that a third-party guarantee, including a standby letter of credit, will not constitute payment with respect to an installment obligation.[227] But care must be taken to ensure that a third-party guarantee does not constitute an evidence of indebtedness of a third party, which, as under prior law, is considered an immediate payment on the installment obigation.[228]

I. Receipt of Like-Kind Property

Section 1031 provides that no gain or loss shall be recognized if property held for productive use in a trade or business or held for investment is exchanged for like-kind property.[229] Where other property or money is received in the exchange, however, gain shall be recognized, but not in excess of the sum of the money and fair market value of the other property re-

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installment debt. *See* Oden v. Commissioner, 56 T.C. 569, 576 (1971) (escrow did not substantially restrict seller's right to full proceeds); 4 B. BITTKER, *supra* note 20, at 106-15 (overlapping theories of economic benefit and constructive receipt regarding escrows); *supra* note 98 (escrow arrangements). See generally Heinlen, *supra* note 13, § 20.03[2][c], at 20-16 to -18, and Comment, *supra* note 98, at 543, for other discussions of the use of escrow arrangements to secure installment obligations.

[225] 627 F.2d 1044 (10th Cir. 1980).

[226] *Id.* at 1048. In addition, the court specifically stated that the letter of credit did not transform the buyer's promise to pay into a completed payment. *Id.*

[227] 1980 S. REP., *supra* note 38, at 18-19, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4713; *see* I.R.C. § 453(f)(3) (West Supp. 1981) (providing that the term "payment" does not include the receipt of evidences of indebtedness of the person acquiring the property, regardless of whether such indebtedness is guaranteed by another person). As under prior law, evidences of indebtedness of the purchaser will constitute payment if they are payable on demand, or if they are issued by a corporation or government entity and are readily tradable. *Id.* § 453(f)(4); Temp. Treas. Reg. § 15A.453-1(b)(3)(i), (iii), *supra* note 67, at 299-300.

[228] *See supra* note 66.

[229] I.R.C. § 1031(a) (1976). A similar nonrecognition rule applies to certain exchanges of insurance policies under § 1035, certain exchanges of stock in the same corporation under § 1036, and certain exchanges of U.S. obligations under § 1037.

ceived.[230] Under prior law, a transfer of property for like-kind property and other property in the form of installment obligations could qualify for both nonrecognition treatment on the like-kind exchange and installment reporting.[231] But, as a practical matter, section 453 was rarely available[232] because the value of the like-kind property received in the exchange was included as a payment received in the year of sale for purposes of the thirty percent limitation.[233] In addition, even if the taxpayer qualified for installment treatment, hardship could result because the taxpayer was also required to include the value of the like-kind property as a payment when computing the recognized gain for the year.[234] Thus, the taxpayer could be required to report gain on the transaction although he had received no cash with which to pay the tax.[235]

The elimination of the thirty percent ceiling will alleviate the qualification problem that plagued taxpayers in the past. In addition, section 453(f)(6)(C), as amended, does not consider the receipt of like-kind property as a payment for purposes of reporting income under the installment method.[236] In effect, recognition of gain will be postponed until cash or other nonlike-kind property is received.

The new Act states that the gross profit from the like-kind exchange will be reduced to take into account any gain not recognized under section 1031(b).[237] Likewise, the total contract

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[230] *Id.* § 1031(b).

[231] Turner v. Commissioner, 36 T.C.M. 1790, 1793 n.7 (CCH 1977); Rev. Rul. 65-155, 1965-1 C.B. 356, 357 (taxpayer who makes like-kind exchange may elect installment reporting).

[232] Giljum, *supra* note 16, at A-26.

[233] Rev. Rul 65-155, 1965-1 C.B. 356, 357; *see* Mitchell v. Commissioner, 42 T.C. 953, 965 (1964) (discussing "selling price" and "initial payment").

[234] Rev. Rul. 65-155, 1965-1 C.B. 356, 357.

[235] The committee reports indicate that this result is contrary to the basic purpose of the installment method, that is, that gain should be recognized when cash and property other than nonrecognition property are received. 1980 S. Rep., *supra* note 38, at 19, *reprinted in* 1980 U.S. Code Cong. & Ad. News 4696, 4714; H.R. Rep., *supra* note 38, at 16.

[236] I.R.C. § 453(f)(6)(C) (West Supp. 1981). This treatment extends to those exchanges mentioned in *supra* note 229 and, in addition, is applicable in the case of an exchange that is incident to a plan of corporate reorganization described in § 356(a) and that is not treated as a dividend. I.R.C. § 453(f)(6) (West Supp. 1981).

[237] *Id.* § 453(f)(6)(B) (West Supp. 1981). Section 1031(b) indicates that where prop-

price is reduced by the value of nonlike-kind property that is received in the exchange.[238]

To illustrate the differences in the new enactment and prior law, compare the results obtained in the following example. Assume the taxpayer exchanges property with an adjusted basis of $200,000 and a fair market value of $500,000 for like-kind property valued at $100,000. Additionally, he receives an installment obligation for $400,000, with $50,000 payable in the year of sale and the balance, including interest at the rate of 12% per annum, payable in the following year.

	Prior Law Rev. Rul. 65-155	Law As Amended
1. Contract Price:		
a. note ($400,000) + FMV of like-kind property ($100,000)	$500,000	
b. sales price ($500,000) - like-kind property received ($100,000)		$400,000
2. Gross Profit: sales price ($500,000) - basis ($200,000)	$300,000	$300,000
3. Gross Profit Ratio:		
a. gross profit ($300,000) ÷ contract price ($500,000)	60%	
b. gross profit ($300,000) ÷ contract price ($400,000)		75%
4. Gain Reported in Year of Sale:		
a. 60% of [cash ($50,000) + FMV of like-kind property received ($100,000)]	$90,000	
b. 75% of cash ($50,000)		$ 37,500
5. Gain Reported in Subsequent Year:		
a. 60% of cash received ($350,000)	$210,000	
b. 75% of cash received ($350,000)		$262,500

erty other than like-kind property is received in the exchange, gain shall be recognized to the extent of the "boot"—the sum of money and the fair market value of other property—received. Thus, in conjunction with § 1031(b), the effect of § 453(f)(6)(B) is to limit gross profit to recognized gain, which in turn may not exceed any boot received in the transaction.

[238] *Id.* § 453(f)(6)(A). In other words, the contract price excludes the value of the like-kind property and consists solely of the sum of money and the fair market value of other property received, including the face amount of the installment obligation. 1980 S. REP., *supra* note 38, at 19, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4714.

6. Total gain recognized: 4. + 5.:	$300,000	$300,000
7. Taxpayers's basis in like-kind property received:[239]	$100,000	$100,000

A more dramatic comparison can be made if in the previous example the taxpayer receives like-kind property valued at $300,000 rather than $100,000 and an installment obligation of $200,000 rather than $400,000, which is payable in a similar manner to that in the first example. Under prior law, because like-kind property was treated as a payment to the recipient,[240] the total payments received in the first year would have been $350,000. Thus, the entire gain would have been recognized initially under prior law because more than 30% of the selling price would have been received in the taxable year of sale.[241]

The 1980 amendment would require treatment as follows:

1.	Contract Price: sales price ($500,000) - like-kind property received ($300,000)	$200,000
2.	Gross Profit: limited to taxable gain	$200,000
3.	Gross Profit Ratio:	

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[239] The Senate report indicates that the basis of like-kind property received is to be determined under § 1031(d). 1980 S. REP., *supra* note 38, at 19-20, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4714. Generally, the rule of § 1031(d) is that the basis of property acquired is the same as that of the property exchanged, decreased by the amount of money received by the taxpayer and increased by his recognized gain. I.R.C. § 1031(d) (1976). Furthermore, Rev. Rul. 65-155, 1965-1 C.B. 356, 357, states that in applying § 1031(d), the transaction must be treated as though the money and other property had been received immediately. Thus, the terms "money received" and "gain recognized" of § 1031(d) must be interpreted to include money to be received and gain to be recognized. *Id.*

Where the taxpayer's basis in the property transferred exceeds the fair market value of the like-kind property received, such excess basis is allocated ratably to the installment obligations and against any cash or other nonqualifying property received on the exchange. Ginsburg, *supra* note 186, § 43.05(1), at 43-25.

Therefore, in the example in the text, the taxpayer first allocated his basis to the property received, limited to its fair market value. The $100,000 balance is thereafter allocated 12.5% to the cash received in the year of sale (recognizing gain of $37,500) and 87.5% to the remaining installment obligations (recognizing gain of $262,500 in the subsequent year). *See id.* § 43.05(1) (other illustrations of basis computations).

[240] *See supra* note 233 and accompanying text.

[241] *See supra* notes 29, 233 and accompanying text.

	gross profit as determined above ($200,000) ÷ contract price ($200,000)	100%
4.	Gain Reported in Year of Sale: 100% of cash ($50,000)	$50,000
5.	Gain Reported in Subsequent Year: 100% of cash received ($150,000)	$150,000
6.	Total gain recognized: 4. + 5.	$200,000
7.	Taxpayer's basis in like-kind porperty received:	$200,000

J. Sales Subject to a Contingency

According to the general rule under prior law, the installment method was not available where a portion of the consideration was contingent upon future events.[242] In the Ninth Circuit Court of Appeals case *In re Steen*,[243] the buyer agreed to pay an additional amount in a contract for sale of stock in a mining corporation if the applicable state mine tax was less than anticipated.[244] Subsequent lititgation over the mine tax was resolved, entitling the seller-taxpayer to the additional amount provided for in the contract.[245] As a result, the Ninth Circuit determined that the selling price at the time of the sale was contingent and, therefore, denied the seller installment treatment.[246] Moreover, the court ruled that the realization and recognition provisions of

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[242] *See In re* Steen, 509 F.2d 1398, 1402-03 (9th Cir. 1975) (additional consideration was part of selling price); Gralapp v. United States, 458 F.2d 1158, 1160 (10th Cir. 1972) (contract provided for additional consideration on sale of oil and gas leases based on future production). In *Gralapp*, the court concluded that because the selling price was indeterminate at the time of sale, § 453 was not available; however, the taxpayer was permitted to report the transaction by the "open" transaction method. 458 F.2d at 1162; *see infra* notes 252-58 and accompanying text (discussing open transactions).

[243] 509 F.2d 1398 (9th Cir. 1975).

[244] *Id.* at 1401.

[245] *Id.*

[246] *Id.* at 1403-04. Professor Bittker has stated the proposition as follows:

> If . . . the selling price cannot be computed with reasonable accuracy because the amount to be paid is dependent on unpredictable future contingencies, the transaction does not qualify under I.R.C. § 453(b) . . . since the uncertainty makes it impossible to compute the "total contract price," which determines the taxpayer's gross profit and hence the taxable portion of the installment payments received.

4 B. BITTKER, *supra* note 20, at 106-13.

sections 1001 and 1002 were controlling and that the part of the consideration with an ascertainable value was taxable in the year of sale.[247]

It should be noted that the contingency in *Steen* resulted in an increase in the contract price. To the contrary, where there has been a downward adjustment of the selling price, the Service has been more lenient and has considered the reduction as a renegotiation of the selling price.[248] Another exception that has allowed qualification for installment treatment results through an agreement providing for an offset against the sales price to indemnify the buyer for breach of certain warranties.[249] In circumstances outside the scope of these exceptions,[250] a taxpayer contemplating a deferred payment sale has faced uncertainty as to how broad a contingency would be permitted.[251]

In other circumstances, the open transaction, or cost recovery, method has been available where the selling price is indeterminate or contingent and is found to have no ascertainable value.[252] Such a transaction is held open for tax purposes and payments received are first applied against the seller's adjusted basis; only after the adjusted basis has been fully recovered is

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[247] 509 F.2d at 1404. The taxpayer was required to report in the year of sale the fair market value of the installment notes received. Thus, the court held that situation was not within the contemplation of "the special treatment [§ 453] reserved for what the Congress thought to be the more clear-cut hardship cases." 509 F.2d at 1405.

[248] *See* Cox v. Commissioner, 62 T.C. 247, 255 (1974) (recomputation of selling price requires adjustment in amount of income to be reported when subsequent installments are collected); Jerpe v. Commissioner, 45 B.T.A. 199, 203-04 (1941) (reduced selling price must be reflected in amount of gain reported after that date); Rev. Rul. 72-570, 1972-2 C.B. 241, 241-42 (same). In the cases and revenue ruling cited in this footnote, there was no indication that the adjustment was contemplated under the original sales contract.

[249] Rev. Rul. 77-56, 1977-1 C.B. 135, 135-36. The ruling indicated that the contract price was fixed whether a warranty is satisfied by full payment or offset against the purchase price. *Id.*

[250] One other exception existed where the sales price would become ascertainable within the taxable year of the sale. Rev. Rul. 76-109, 1976-1 C.B. 125, 125-26.

[251] 1980 S. REP., *supra* note 38, at 23, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4717. Left unanswered were questions such as qualification of a transaction in which a contingency in selling price did not materialize. *See generally* Giljum, *supra* note 16, at A-23 (discussing indeterminate or contingent selling price); 10 FED. TAX COORDINATOR 2D (RIA) G-6054, at 24,357-59 (1981) (same).

[252] *See* Burnet v. Logan, 283 U.S. 404, 412 (1931); Karjala, *Taxing the Sale of Property*, 1980 DUKE L.J. 417, 447-51 (judicial approach to sales where contract price has no ascertainable value).

any gain recognized.[253] The Commissioner clearly stated in the same regulation that permits deferred payment recognition under the open transaction method that "only in rare and extraordinary cases does property have no fair market value."[254] This method has been employed most frequently when the sales price is determined with reference to later production or income from the property sold.[255] In addition, a buyer's evidence of indebtedness consisting of a mere contractual obligation has afforded the seller open transaction treatment.[256] Thus, an unsecured promise represented only by a nonnegotiable note or contract right has been considered to have no fair market value and, therefore, does not constitute "property" as contemplated by section 1001(b).[257] On the other hand, where the debt is secured or represented by a negotiable instrument, the transaction ordinarily is held to be closed.[258]

Under the 1980 Act, Congress expanded the availability of

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[253] Burnet v. Logan, 283 U.S. 404, 413 (1931); Treas. Reg. § 1.453-6(a)(2) (1958).

[254] Treas. Reg. § 1.453-6(a)(2) (1958).

[255] *See* Burnet v. Logan, 283 U.S. 404, 410 (1931) (seller received fixed sum and an additional 60 cents per ton of ore produced.

[256] *See, e.g.*, Schlemmer v. United States, 94 F.2d 77, 78 (2d Cir. 1938) (note exchanged for services was not taken as payment but as permanent evidence of indebtedness); Estate of Hurbert v. Commissioner, 25 T.C. 1286, 1288-89 (1956) (contract for deferred payments on real estate was not an amount realized); Ennis v. Commissioner, 17 T.C. 465, 470 (1951) (contractual obligation without evidence of indebtedness was not cash equivalent).

[257] *See* Nitterhouse v. United States, 207 F.2d 618, 619-20 (3d Cir. 1953) (government's obligation to pay landowner for land taken by eminent domain does not constitute "property" within the meaning of the Internal Revenue Code). The theory behind the taxpayer's argument in *Nitterhouse* was that the buyer's promise to pay was not the equivalent of cash to a cash-basis taxpayer. *Id.; see also* Western Oaks Bldg. Corp. v. Commissioner, 49 T.C. 365, 377 (1968) (test is whether debtor's promise to pay is embodied in evidences of indebtedness that commonly change hands in commerce). *See generally* 2 J. MERTENS, *supra* note 4, §§ 11.01-.05 (cash equivalents).

[258] *See, e.g.*, Lowe v. Commissioner, 44 T.C. 363, 371-72 (1965) (unconditional promise to pay that was secured by government bonds held to have an ascertainable fair market value equal to its face); Barnsley v. Commissioner, 31 T.C. 1260, 1262-63 (1959) (negotiable notes received in exchange for oil leases held to be income in the year received); Bones v. Commissioner, 4 T.C. 415, 422-23 (1944) (face amount of note was includable in income in the year received, notwithstanding contract provided for adjustments if certain events occurred). In a more recent case, the Ninth Circuit Court of Appeals held that a transaction was closed although a determination was made that the present value of the contract was only equal to 60% of the face amount. Warren Jones Co. v. Commissioner, 524 F.2d 788, 790, 794 (9th Cir. 1975).

the installment method to include sales in which the price is subject to a contingency.[259] Recognizing that it could not prescribe rules encompassing all transactions of this nature, Congress delegated the task to the Treasurey Department.[260] Section 453(i)(2) provides that regulations shall be issued providing for ratable basis recovery in transactions where the gross profit or the total contract price is not readily ascertainable.[261] Generally, the temporary regulations indicate that the liberalized installment treatment for sales subject to a contingency will be allowed when a stated maximum selling price exists, when the obligation is payable over a fixed period of time, and in appropriate other cases.[262] Both committee reports further indicate that the new rules eliminate the need for treating transactions as open in fixed purchase price cases and reduce the justification for such treatment in cases where the purchase price is contingent.[263]

Where a maximum selling price can be determined from the sales contract, the temporary regulations and the committee reports propose gain recognition based on the gross profit ratio calculated with reference to that maximum selling price.[264] If it

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[259] I.R.C. § 453(i)(2) (West Supp. 1981).

[260] 1980 S. REP., *supra* note 38, at 23, *reprinted in* 1980 U.S.CODE CONG. & AD. NEWS 4696, 4718; 1980 H.R. REP., *supra* note 38, at 20. The temporary regulations that deal with contingent payment sales follow closely the guidelines set forth in the committee reports. *See* Temp. Treas. Reg. § 15A.453-1(c), *supra* note 67, at 301-08.

[261] I.R.C. § 453(i)(2) (West Supp. 1981).

[262] 1980 S. REP, *supra* note 38, at 23-24, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4718; 1980 H.R. REP., *supra* note 38, at 20-21.

[263] 1980 S. REP., *supra* note 38, at 24, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4719; 1980 H.R. REP., *supra* note 38, at 21. The Senate report explains the intent of the new rules:

> [T]he cost-recovery method [should] not be available in the case of sales for a fixed price (whether the seller's obligation is evidenced by a note, contractual promise, or otherwise), and . . . its use [should] be limited to those rare and extraordinary cases involving sales for a contingent price where the fair market value of the purchaser's obligation cannot reasonably be ascertained.

1980 S. REP., *supra* note 38, at 24, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4719. Although this statement denies the use of the cost recovery method by a cash-basis seller who receives a mere contractual obligation, it does not represent a change from prior law. *See supra* notes 242-58 and accompanying text. *See generally* Mylan, *Cost Recovery as a Method of Reporting Gain from Disposition of Property*, 8 WILLAMETTE L.J. 1, 1-36 (1972) (cost recovery method); 10 FED. TAX COORDINATOR 2D (RIA) ¶¶ G-6400 to -6432 (1981) (deferred payment sales).

[264] 1980 S. REP., *supra* note 38, at 23, *reprinted in* 1980 U.S. CODE CONG. & AD.

is later determined that all or part of the contingency will not be satisfied and, as a result, the selling price is reduced, the gain is to be recomputed.[265] The taxpayer would then use the adjusted gain to recompute the gross profit percentage, which would be used for installment payments received in the taxable year of adjustment and in subsequent taxable years.[266] In addition, the temporary regulations indicate that where the taxpayer has reported more gain from installment payments received in previous tax years than the total recomputed gain, the taxpayer would be permitted to deduct the excess as a loss in the adjustment year.[267]

The operation of these temporary regulations can be demonstrated by a brief example. Assume that a taxpayer sells land based on a percentage of gross receipts obtained from oil production on the property. The taxpayer's adjusted basis in the property is $200,000. A maximum selling price is set at $800,000, exclusive of interest, and payments are to be made annually over four years, with adequate interest on the unpaid balance. Using the maximum selling price, the gross profit ratio is 75%, so 75% of each payment received would be recognized as gain and 25% would be basis recovery. If during the fourth year, the oil wells become dry and the purchaser ceases operations, having made only $600,000 in payments, the taxpayer may take a loss of $50,000. The loss is equal to the unrecovered basis—$200,000 − (25% x $600,000). It should be noted that an unrealistically high maximum selling price will result in a higher gross profit ratio, which in turn will cause a smaller tax-free recovery of basis on each payment received.

In the event the installment obligation is payable over a fixed period of time, even though the sales price is indefinite and

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NEWS 4696, 4718; 1980 H.R. REP., *supra* note 38, at 20; Temp. Treas. Reg. §15A.453-1(c)(2)(i)(A), *supra* note 67, at 301-02.

[265] 1980 S. REP., *supra* note 38, at 23, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4718; 1980 H.R. REP., *supra* note 38, at 20; Temp. Treas. Reg. §15A.453-1(c)(2)(i)(A), *supra* note 67, at 301-02.

[266] 1980 S. REP., *supra* note 38, at 23, *reprinted in* 1980 U.S. Code Cong. & Ad News 4696, 4718; 1980 H.R. REP., *supra* note 38, at 20; Temp. Treas. Reg. §15A.453-1(c)(2)(i)(A), *supra* note 67, at 301-02.

[267] Temp. Treas. Reg. § 15A.453-1(c)(2)(ii), *supra* note 67, at 304 (example 5).

no maximum selling price can be determined, the committee reports state that the seller's adjusted basis should be recovered ratably over the fixed period.[268] If in any year the taxpayer should receive a payment that is less than the basis allocable to that year, no loss will be allowed at that time.[269] Any unrecovered basis must be carried forward to the succeeding year, and a loss will be allowable only in the year in which it is demonstrated that the seller's entire adjusted basis will not be fully recovered.[270]

As mentioned, even though a contingent sale involves neither a maximum stated selling price nor payments that are to be received over a fixed period, the new, liberalized treatment can still be obtained in appropriate other cases. An income forecast method of basis recovery will be considered "appropriate" for a transaction in which it is determined that payments will be greater in the earlier years after the sale and then decline in the years thereafter.[271] The Treasury Department is given authority to prescribe regulations for the application of the forecast

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[268] 1980 S. REP., *supra* note 38, at 23, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4718; 1980 H.R. REP., *supra* note 38, at 20.

Where payments under an agreement are not limited by a maximum amount or a stated period of time, a question arises as to whether a sale has realistically occurred, and whether the payments are really in the nature of rent or royalty income. Temp. Treas. Reg. § 15A.453-1(c)(4), *supra* note 67, at 305. If the arrangement is determined to qualify as a sale, the temporary regulations indicate that the taxpayer's basis shall be recovered in level increments over a 15-year term. *Id.* In the event payment received in a year is less than the basis allocable to that year, the excess basis shall be reallocated in level amounts over the balance of the 15-year term. *Id.* Any basis not recovered at the end of the 15th year shall then be carried forward to the next succeeding year and no loss will be allowed until the future payment obligation is determined to be worthless. *Id.*

[269] Temp. Treas. Reg. § 15A.453-1(c)(3), *supra* note 67, at 304-05; *see supra* note 268.

[270] Temp. Treas. Reg. § 15A.453-1(c)(3), *supra* note 67, at 304-05; *see supra* note 268.

[271] 1980 S. REP., *supra* note 38, at 23-24, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS. 4696, 4718; 1980 H.R. REP., *supra* note 38, at 20-21. When properties such as motion picture films, television films, and mineral properties are sold for contingent payments keyed to later proceeds from or productivity of that property, the income forecast method may be the appropriate method of recovering the seller's adjusted basis. Temp. Treas. Reg. § 15A.453-1(c)(3), *supra* note 67, at 306; *see* Ginsburg, *supra* note 186, § 43.03(4) (forecast method).

method.[272] Particular attention is to be given by the Department to ensure that a seller is not left with an unrecovered adjusted basis in the obligation that would generate a capital loss.[273]

Although Congress has expanded the use of installment reporting to cover circumstances where the selling price is subject to a contingency, the Act may in fact have introduced more confusion into this area of the law. The committee reports indicate that the cost recovery method, which is used for open transactions, may still be available in "rare and extraordinary" circumstances.[274] Thus, if a taxpayer attempts to structure an open transaction and to elect out of installment reporting, but the Service refuses the taxpayer's argument that the fair market value of the purchaser's obligation is not readily ascertainable, the cost recovery method will be denied.[275] Moreover, because the decision to elect out of installment reporting may be revoked only with the consent of the Service,[276] the taxpayer may be required to recognize the full gain in the year of sale.[277] So these rules may be a trap for the unwary and also may inhibit taxpayers from utilizing commercially reasonable contingent payment obligations in future sales of property.[278]

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[272] 1980 S. REP., *supra* note 38, at 24 n.31, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4719.

The Senate report indicates that the income forcast method is available whether the contingent sale contract is linked to a stated maximum selling price, a fixed term agreement, or an unlimited payment arrangement. *Id.*, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4719.

[273] *Id.*, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4719.

[274] *See supra* note 263.

[275] For examples of cases in which taxpayers have attempted to use the cost recovery method, see Mylan, *supra* note 263, at 13-16.

[276] I.R.C. § 453(d)(3) (West Supp. 1981). A taxpayer may not preserve the right to use § 453 by making his election out of installment reporting conditional upon the Service's acceptance of the open transaction treatment. *See* Temp. Treas. Reg. § 15A.453-1(d)(3)(ii), *supra* note 67, at 309; Ginsburg, *supra* note 186, §43.07.

[277] If the fair market value of the installment debt is less than its face value, some deferral of gain will result. Any payment received in excess of the fair market value, however, will generally be characterized as ordinary income because the payments are not held to be part of the original sale or exchange. Campagna v. United States, 290 F.2d 682, 683-84 (2d Cir. 1961); Rev. Rul. 58-402, 1958-2 C.B. 15, 15. But where the purchaser is either a corporation or a governmental entity, § 1232(a) specifically provides that the payments on the obligation shall be treated as a sale or exchange to afford capital gain treatment. I.R.C. § 1232(a) (1976).

[278] *See* Hammond, *supra* note 62, at 72-73.

K. Election of Installment Method by an Accrual Basis Dealer

As discussed earlier in connection with the history of the installment method, hardship resulted to an accrual method dealer in personal property who elected to use installment reporting. A dealer making the election was required to include currently in gross income those payments received on sales in previous years even though the entire gain with respect to the sales had been recognized in earlier years.[279] Mitigation of the double taxation was permitted by a corresponding adjustment to tax.[280] The adjustment, however, was subject to a limitation equal to the lesser of either (1) the portion of income tax attributable to the inclusion of the gain in income in the original year of sale or (2) the portion of income tax resulting from the inclusion in income of the gross profit from payments received in the subsequent years.[281] Thus, if the taxpayer was in a higher tax bracket in the year the election was made, the gain on payments from a sale previously reported would be taxed at the higher rate because of the conversion to the installment method.[282]

Notwithstanding the tax adjustment allowed, the Senate Finance Committee indicated that the inclusion in income of gains previously reported is a form of double taxation.[283] Furthermore, the Committee believed that the mechanism for adjustment of tax under the law prior to the Act imposed unnecessary complexities upon dealers who elect the installment method.[284] As a result, the Act repeals the prior provision. Under the new legislation, an accrual method dealer who elects the installment

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[279] I.R.C. § 453(c) (1976 & Supp. II 1978) (repealed by the Installment Sales Revision Act of 1980, § 2(a)).

[280] I.R.C. § 453(c)(2) (1976) (repealed by the Installment Sales Revision Act of 1980, § 2(a)).

[281] Treas. Reg. § 1.453-7(b) (1958).

[282] *See* Giljum, *supra* note 16, at A-13 (example of tax adjustment arising from the change of method). Giljum states that the profit is taxed at a higher rate because "the adjustment is the *lesser* of the tax previously paid on the portion of profit currently received but previously included under the accrual method, or the tax at the current year's rate on that profit." *Id.*

[283] 1980 S. REP., *supra* note 38, at 25, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4720.

[284] *Id.* at 24-25, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4719-20.

method of reporting will simply report gain as payments are received from sales made on or after the effective date of the installment election.[285]

L. Transfers of Installment Obligations to Life Insurance Companies

Generally, the disposition of an installment obligation requires the seller to recognize any previously unreported gain.[286] In certain tax-free transfers, however, the disposition will not trigger recognition of gain, and the transferee takes the obligation at the transferor's basis, with the duty to report the unreported gain as the payments are received.[287] Under prior law, a special rule prohibited this nonrecognition treatment to otherwise tax-free transfers of installment obligations to a life insurance company.[288] The Act now extends equal treatment to life insurance companies. Nonrecognition of unreported gain on a transfer, however, will only be allowed if the life insurance company elects to report such gain as investment income, under section 804(b), as payments are received.[289]

M. Cancellation of an Installment Obligation

The legislative objective in enacting the rules for dispositions of installment obligations was to prevent deferred gain from escaping taxation when an installment obligation is transferred to a third party.[290] Ordinarily, the rules require either

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[285] I.R.C. § 481(a) (West Supp. 1981). The committee's intent is that a failure to report the full amount of gain from sales may be treated as an election of the installment method. 1980 S. REP., *supra* note 38, at 25, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4720. An example of such a situation would be where a dealer treated gain from a lease as rental income, and thereafter an audit by the Service recharacterized the transaction as a sale. *Id.*, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4720. The expressed intent of the committee, however, is that no taxpayer who has reported sales under the accrual method will be required to change from that method. *Id.*, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4720.

[286] I.R.C. § 453B (West Supp. 1981); *see* 4 B. BITTKER, *supra* note 20, at 106-18 to -23; Chandler, *supra* note 16, at 447-50.

[287] 4 B. BITTKER, *supra* note 20, at 106-18 to -19, 106-21 to -22.

[288] I.R.C. § 453(d)(5) (1976) (current version at *id.* § 453B(e)(1) (West Supp. 1981)).

[289] *Id* § 453B(e)(1) (West Supp. 1981).

[290] 4 B. BITTKER, *supra* note 20, at 106-22 to -23.

that the transferor report the gain upon disposing of the obligation or that the third-party transferee recognize the gain as payments are received.[291] One case, however, has held that a gratuitous transfer of an installment obligation to the obligor would not cause a recognition of gain. In *Miller v. Usry*,[292] a taxpayer sold real property to his son on the installment method. Thereafter, receiving no consideration, the father cancelled the note, and the related mortgage given as security for the note.[293] The district court reasoned that the obligation had been satisfied at other than its face value, and, thus, the governing provision required the taxpayer to recognize gain on the amount realized rather than on the fair market value of the note at the time of the cancellation.[294] When an obligation is transferred by gift or bequest the amount realized is zero; therefore, the court concluded that the father had no taxable gain.[295] Although there was no actual benefit accruing to the taxpayer, the court failed to consider that the son had received a stepped-up basis in the property through the installment sale.[296] To avoid the result ob-

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[291] *See* I.R.C. § 453(d) (1976) (current version at *id.* § 453B (West Supp. 1981)).

[292] 160 F. Supp. 368 (W.D. La. 1958).

[293] *Id.* at 368-69.

[294] *Id.* at 372. Former § 453(d)(1) set forth the general rule that distinguished between a (1) sale or exchange, or satisfaction at other than face value, and (2) any other distribution, transmission, or disposition. *Id.* § 453(d)(1) (1976) (current version at *id.* § 453B(a) (West Supp. 1981)). For transactions in (1) above, gain or loss resulted to the extent of the difference between the basis of the obligation and the amount realized. *Id.* § 453(d)(1)(A) (current version at *id.* § 453B(a)(1) (West Supp. 1981)). For group (2), gain or loss was determined on the basis of the fair market value of the obligation at the time of the transfer. *Id.* § 453(d)(1)(B) (current version at *id.* § 453B(a)(2) (West Supp. 1981)).

Under prior law, when an obligation was transferred to the obligor in a nonrecognition transaction, the transfer did not trigger realization of gain by the transferor. 4 B. BITTKER, *supra* note 20, at 106-23. Moreover, no gain could result to the transferee because the entities of debtor and creditor had merged, and the obligation had, in effect, been eliminated. *Id.* To remedy this problem, the Service issued a ruling that stated that the transfer of an installment obligation to the obligor in a nonrecognition transaction constitutes its "satisfaction at other than face value." Rev. Rul. 73-423, 1973-2 C.B. 161, 162. As a result, the nonrecognition provisions were inapplicable, and the transaction was subject to § 453(d)(1)(A). Although the ruling provided a way to tax the transferor on the deferred gain, additional problems arose if the transfer were a gift because then case the amount realized would be zero.

[295] 160 F. Supp. at 371-72.

[296] *See* Wilkinson v. Commissioner, 49 T.C. 4, 11-12 (1967) (complete escape of

tained in *Miller*,[297] the new Act makes it clear that the cancellation of an installment obligation is to be treated as a disposition.[298] As a result, a gratuitous transfer will be governed by the provision that requires taxation on the difference between the basis and the fair market value of the obligation.[299] Furthermore, where the obligor is a related party, the new Act states that the fair market value is not to be treated as less than the face amount of the installment obligation.[300]

N. Bequest of Installment Obligation to Obligor

Generally, no gain is required to be recognized from the transmission of an installment obligation upon the death of the holder.[301] Rather, the transferee is required, upon receipt of payments, to report ratably the portion of unreported gain inherent in the obligation as income in respect of a decedent. Such gain is recognized by the transferee in the same manner as the decedent would have reported the gain had he or she lived.[302]

If the seller, however, bequeaths the installment obligation to the obligor of the original transaction, the tax treatment will be similar to that given when the obligation is gratuitously

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taxation would be "absurd result"); 1980 S. REP., *supra* note 38, at 26, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4721 (discussing *Miller*).

[297] *See supra* notes 292-96 and accompanying text.

[298] I.R.C. § 453B(f)(1) (West Supp. 1981).

[299] *Id.* § 453B(a)(2).

[300] *Id.* § 453B(f)(2).

[301] *Id.* § 453(d)(3) (1976) (current version at *id.* § 453B(c) (West Supp. 1981)); Treas. Reg. § 1.451-1(b)(2) (1958).

[302] I.R.C. § 691(a)(4)(A)-(B) (1976). The section states that the portion of each installment payment representing income in respect of a decedent is the excess of the face amount of the obligation over its basis in the hands of the decedent. *Id.* § 691(a)(4)(A). Basis, determined under former § 453(d)(2), current § 453B(b), is the excess of the face value of the obligation over an amount equal to the gain that would be returnable were the obligation satisfied in full.

Although the installment obligation will be included in the gross estate of the decedent to the extent of fair market value, a recipient of income in respect of a decedent is not entitled to an increase or decrease in basis from the inclusion of the amount in the gross estate. *See id.* § 1014(c) (1976) (basis rule of § 1014 not applicable to income in respect of a decedent). The recipient is, however, entitled to a deduction for estate taxes attributable to inclusion of the unreported gain portion of the installment obligation in the decedent's gross estate. *Id.* § 691(c) (1976).

transferred inter vivos to the obligor.[303] Because the interests of the obligor and obligee merge, neither the collection of the unpaid debt nor a gain accelerating disposition would ever occur.[304] Thus, the obligor could receive a stepped-up cost basis in the property that was acquired in the deferred payment sale without him or the decedent, as the seller, recognizing income at the time of the seller's death.[305]

To prevent a buyer from obtaining a stepped-up basis without a corresponding gain recognition, the Act provides that any previously unreported gain from an installment sale will be recognized in full by the deceased seller's estate upon transmission of the obligation to the obligor by bequest, devise, inheritance, or upon cancellation by the executor.[306] It should be noted that the application of the statute goes beyond a specific bequest to the obligor.[307] For example, if the obligation passed through the decedent's residuary estate to the obligor, the provision that includes transfers by inheritance would become effective.[308] In addition, if a transfer is made and the decedent and the obligor are related parties within the meaning of section 453(f)(1), the fair market value of the obligation will be considered as not less than its face value for determining gain.[309]

O. Foreclosure of Real Property Sold on the Installment

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[303] *See supra* notes 290-95 and accompanying text.

[304] 1980 S. REP., *supra* note 38, at 26-27, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4721-22.

[305] *Id.* at 27, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4722.

[306] I.R.C. § 691(a)(5)(A)(i)-(ii) (West Supp. 1981). The Senate report states that in the absence of some act cancelling the obligation under the Uniform Commercial Code or other local law, the transmission will be considered to occur no later than that time in which the administration of the estate is concluded. 1980 S. REP., *supra* note 38, at 27, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4722. Furthermore, for purposes of the amended provision, an installment obligation that becomes unenforceable shall be treated as if it were cancelled. I.R.C. § 691(a)(5)(C) (West Supp. 1981).

[307] Emory & Hjorth, *Installment Sales Act, Part II: Cost Recovery, 337 Liquidations, Related Parties, Dispositions*, 54 J. TAX'N 130, 137 (1981). Because the receipt of an installment obligation by a person other than the obligor will permit continued deferral, testators normally should not make specific bequests of an installment obligation to the obligor.

[308] *Id.* Thus, where an obligor is an heir, precaution must be taken to avoid the obligor inheriting any part of an installment obligation.

[309] I.R.C. § 691(a)(5)(B) (West Supp. 1981).

Method by a Deceased Taxpayer

Section 1038 prescribes special rules governing a seller's reacquisition of real property in satisfaction of an indebtedness subsequent to a sale that gave rise to the indebtedness secured by the property. Under the provision, gain results to the seller to the extent that any money and the fair market value of other property received by the seller prior to the reacquisition exceeds that amount of gain on the sale previously recognized by the seller.[310] To prevent the seller from recognizing gain on what is actually a return of capital, however, the amount to be taxed is limited to the remaining unreported portion of the original gain.[311]

To demonstrate the application of section 1038, assume that a taxpayer sells land with an adjusted basis of $180,000 for $360,000. The taxpayer receives $60,000 as a downpayment, and

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[310] *Id.* § 1038(b)(1) (1976). Prior to the enactment of § 1038 in 1964, the seller would realize gain or loss when property was reacquired from a defaulting purchaser. *See* 2 B. BITTKER, *supra* note 20, at 44-79 to -82 (history of § 1038).

The general rule of § 1038 provides that no gain or loss results to the seller from a qualified reacquisition of real property and no debt becomes worthless or partially worthless as a result of the reacquisition except as provided. I.R.C. § 1038(a) (1976). Despite the general rule, a provision is made with respect to gains for recognition upon reconveyance of real property sold, limited to the lesser of the amount of any unreported portion of the original gain or the amount by which the sum of the money and fair market value of property received prior to the reacquisition exceeds the amount of gain previously recognized. *Id.* § 1038(b). Another exception to the general rule is imposed by § 1038(d), which requires a seller who wrote off the debt secured by the reacquired property as partially or wholly worthless to treat the amount of the write-off as a recovery of the bad debt. If no tax benefit accrued to the seller as a result of the deduction, then the write-off does not have to be added back into income. *See* Treas. Reg. § 1.1038-1(f)(2) (1967).

[311] I.R.C. § 1038(b)(2) (1976). The provision states that the remaining unreported gain is the excess of the sales price over the adjusted basis of the property, less (1) any gain previously reported and (2) any money and other property (except the purchaser's obligations) paid by the seller in connection with the reacquisition. *Id.* Amounts received as interest, both stated and unstated, are not considered as money. Treas. Reg. § 1.1038-1(b)(2)(iii) (1976). Any indebtedness placed on the property after the sale, however, will be treated as an amount paid by the seller because the property is encumbered by the additional amount. *Id.* § 1.1038-1(c)(4)(ii). The effect of the provision is to restrict the seller's taxable gain to the net amount of cash and other property obtained from the sale. 2 B. BITTKER, *supra* note 20, at 44-82.

Since the amount of the limitation is determined with reference to the selling price, the limiting provision will not be applicable when the price is indefinite and cannot be ascertained at the time the property is reacquired. Treas. Reg. § 1.1038-1(c)(2) (1967).

the remaining $300,000 is payable in ten installments of $30,000 per year, together with interest at 12% per annum on the unpaid balance. After the purchaser has made two installment payments, he defaults and voluntarily reconveys the property in satisfaction of the outstanding indebtedness.

Computation of Gain on Reacquisition[312]

1. Selling Price		$360,000
2. Less: Adjusted basis		180,000
3. Excess of selling price over adjusted basis		$180,000
4. Amount paid by buyer		
a. Downpayment		$60,000
b. Payment of installments (2 at 30,000/year)		60,000
c. Total paid		$120,000
5. Gain reported		
a. At time of sale	$\frac{\$360,000 - \$180,000}{\$360,000} \times \$60,000 =$	$30,000
b. Upon receipt of installments	$\frac{\$360,000 - \$180,000}{\$360,000} \times \$60,000 =$	30,000
c. Total gain reported		$60,000
6. Gain on reacquisition — I.R.C. § 1038(b)(1)		
a. Amount received by seller 4.c.		$120,000
b. Less: Gain previously reported		60,000
c. I.R.C. § 1038(b)(1) gain		$60,000
7. I.R.C. § 1038(b)(2) limitation		
a. Selling price		$360,000
b. Less: Basis		180,000
c. Less: Gain previously reported		60,000
d. Less: Amount paid by seller on reacquisition		-0-
e. I.R.C. § 1038(b)(2) limitation		$120,000
8. Gain recognized under I.R.C. § 1038(b)		

[312] The format for this illustration was borrowed from example 44-12, 2 B. BITTKER, *supra* note 20, at 44-85.

(lesser of lines 6.c. or 7.e.)	$60,000
9. Total gain recongnized[313] (sum of lines 5.c. and 8)	$120,000

In Revenue Ruling 69-83,[314] the Service ruled that the nonrecognition provisions of section 1038 did not apply to a reconveyance of real property to the estate of a deceased seller. The committee reports for the new Act, however, recognize that in the event of a reconveyance of real property in satisfaction of an obligation, a decedent's estate should be entitled to the same limitations on recognition of gain as the decedent would have been entitled to had he survived.[315] As a result, the Act revokes the Service's ruling and extends the limitation of section 1038(b)(2) to the estate or other beneficiary inheriting the installment obligation.[316]

In the hands of the repossessing estate or beneficiary, the property will be given a basis equal to the basis the original seller would have obtained if he had reacquired the property.[317] The basis so obtained shall then be increased by an amount equal to the section 691(d) deduction for estate taxes that would have been allowed if the repossession had been taxable.[318] Section 1038(c), the provision for computing the original seller's basis, assigns a basis to the repossessed property equal to the adjusted basis of the debt secured by the property, determined at the time of the repossession, plus any gain recognized on repossession, any expense incurred by the seller in repossessing the property, and any money or property, except the buyer's obligations, transferred by the seller in connection with the reacquisition.[319] For purposes of determining the adjusted basis of the

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[313] *Id.* at 44-83 to -84. The total gain recognized by the taxpayer under § 1038 corresponds to the sum of the payments received by him. Any appreciation in the property remains unrecognized because, practically, it has not been converted into cash or other property. *Id.*

[314] Rev. Rul. 69-83, 1969-1 C.B. 202.

[315] 1980 S. REP., *supra* note 38, at 27-28, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4722-23; 1980 H.R. REP., *supra* note 38, at 23.

[316] I.R.C. §1038(g)(1) (West Supp. 1981).

[317] *Id.* § 1038(g)(2).

[318] *Id.*

[319] *Id.* § 1038(c); Treas. Reg. § 1.1038-1(g)(1), T.D. 6916, 1967-1 C.B. 207, 208. The legislative objective of § 1038(c) is to place the taxpayer in the position he occupied

debt, section 453B(b) provides that the basis of the installment obligation shall be the excess of the face value of the obligation over the amount of income that would be recognized if the obligation were satisfied in full.[320]

Conclusion

The Installment Sales Revision Act has left unaltered the general mechanism and underlying concept of the installment method. Consistent with the policy of the original enactment, the Act continues to operate as a relief provision by postponing recognition of gain on a deferred payment sale until the year in which payment is received.[321]

Although the 1980 amendment is hailed as major simplification legislation, the foregoing analysis suggests that the Act is in fact comprehensive and often complex. Simplification, however, should not be judged by the nature of the statute alone, but rather by its utility and its application.[322] In this regard, the installment sales rules have been significantly liberalized to avoid

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before the sale, with adjustments for gain recognized on the reacquisition, in order to ensure "that . . . upon resale of the property [he] will report any gain not previously reported, to the extent reflected in the current market value of the property." 1964 S. Rep. No. 1361, 88th Cong., 2d Sess. 5, *reprinted in* 1964 U.S. Code Cong. & Ad News 3573, 3579; *see* 2 B. Bittker, *supra* note 20, at 44-84 to -87.

[320] I.R.C. § 453B(b) (West Supp. 1981). In the textual example, basis would be determined as follows:

1. Basis of the purchaser's indebtedness to the seller under § 453B(b)

$$\$240{,}000 - \left[\$240{,}000 \times \left(\frac{360{,}000 - 180{,}000}{360{,}000}\right)\right] = \$120{,}000$$

2. Amount of gain recognized on the reacquisition 60,000
3. Basis in the reacquired property $180,000

See generally 2 B. Bittker, *supra* note 20, at 44-84 to -87 (basis in reacquired property).

[321] *See supra* note 8 and accompanying text.

[322] Ginsburg, *supra* note 186, § 43.11. The installment sales legislation was the result of an extensive effort on the part of the Treasury Department, the staff of the Joint Committee on Taxation, other congressional staff attorneys, major bar association tax groups, and the Federal Tax Division of the AICPA. *Id.* at 43-67. As a result of the diversity of interests represented, much of the effort went into identifying the competing policies and objectives and attempting to harmonize those objectives. *Id.* at 43-67 to -68. The competing concerns included achieving the tax policy and balancing the revenue costs to the government and the burden that the taxpayer must shoulder. *Id.* at 43-69 to -70.

the traps laid for the unwary under prior law. With the elimination of the initial-payment ceiling[323] and the selling price limitation for casual sales of personal property,[324] the average taxpayer may obtain the advantages of installment treatment with almost the same ease as the well-informed, sophisticated practitioner. In addition, use of section 453 will be facilitated by the automatic application of installment reporting to qualified sales.[325] Finally, greater flexibility is allowed in structuring deferred payment sales by the elimination of the two-payment rule that was previously used in determining eligibility.[326]

In some instances the Act has sought to curve taxpayer abuse and has thereby reduced planning opportunities. The ability to obtain tax deferral by installment treatment with immediate receipt of cash within the family group has been substantially diminished.[327] Also, a cancellation of an installment obligation or a devise to an obligor will no longer result in nonrecognition.[328] This technique will now have the effect of a taxable disposition.[329] Planning opportunities remain, but creative practitioners and taxpayers must do some analysis to avail themselves fully of the benefits obtainable under the revised installment provisions.

Despite the comprehensive nature of the Act, uncertainties still exist. The legislative history of the Act clearly demonstrates that Congress intended for the Treasury Department to issue extensive regulations under the statute.[330] Furthermore, section 453(i)(l) grants the Secretary broad discretion to promulgate regulations necessary to implement the new legislation.[331] Thus, many areas of the Act will be dependent upon the forthcoming regulations. Continued conflict and litigation can be expected

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[323] *See supra* notes 45-69 and accompanying text.
[324] *See supra* notes 80-82 and accompanying text.
[325] *See supra* notes 83-89 and accompanying text.
[326] *See supra* notes 70-79 and accompanying text.
[327] *See supra* notes 152-81 and accompanying text.
[328] *See supra* notes 290-309 and accompanying text.
[329] *See supra* notes 298-99, 306-09 and accompanying text.
[330] *See supra* notes 260-61 and accompanying text.
[331] I.R.C. § 453(i)(1) (West Supp. 1981).

between taxpayers and the Service in resolving those uncertainties generated by the new Act.

Robert V. Baker

RECENT DECISIONS

Conflict of Interest—Public Officials—A Legislator Is Guilty of a Misdemeanor if He Has a Direct Interest in a Contract Authorized by the Legislature

The State of Mississippi brought criminal charges alleging that the defendant[1] violated section 97-11-19 of the Mississippi Code[2] when he affirmatively voted for appropriations authorizing funds for a state agency[3] that subsequently entered into a contract with a corporation[4]

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[1] In November, 1975, the defendant, Napolean "Nap" L. Cassibry, II, was elected to the Mississippi Legislature as a State Senator for Post Two of District 32, Harrison County. Cassibry v. State, 404 So. 2d 1360, 1362 (Miss. 1981). The defendant was to have served a full four-year term beginning in January, 1976, but resigned in February, 1979. *Id.*

[2] The applicable portions of Miss. Code Ann. § 97-11-19 (Supp. 1981) are as follows:

> If any public officer or member of the legislature, . . . shall be interested, directly or indirectly, in any contract with the state, . . . authorized by any law passed or order made by any board of which he may be or may have been a member during the term for which he shall have been chosen or within one (1) year after the expiration of such term, he shall be guilty of a misdemeanor and shall be fined a sum equal to double the value of the contract or imprisoned in the county jail not less than one (1) month nor more than one (1) year . . . .
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> Instead of a criminal procedure against the officer . . . a civil proceeding may be instituted against any officer or officers or members of any board or boards so offending for double the value of the contract by or on behalf of the state, county, municipality or district so affected, as the case may be. These remedies are alternative, not cumulative, and for double the amount of the contract so made; and the remedy in any case first instituted, whether civil or criminal, shall be exclusive, barring, if civil, any criminal prosecution; and if criminal proceeding, then any civil suit for same transaction.

This same prohibition against an interest in public contracts is enunciated in Miss. Const. art. IV, § 109:

> No public officer or member of the legislature shall be interested, directly or indirectly, in any contract with the state, . . . authorized by any law passed or order made by any board of which he may be or may have been a member, during the term for which he shall have been chosen, or within one year after the expiration of such term.

[3] The State Department of Public Welfare, under Miss. Code Ann. § 43-1-17 (1972), uses funds appropriated by the legislature to match a percentage of federal funds under the federal government's Title XX social services program, which provides assistance to

in which the defendant had a direct interest.[5] The defendant contended that the appropriations bills[6] he voted for did not "authorize" the contract[7] within the meaning of section 97-11-19[8] and, alternatively, even if the bills were authorizations, he was still not liable because section 97-11-19 was unconstitutionally vague.[9] Furthermore, the defendant claimed that regardless of the aforementioned factors, he was nevertheless entitled to immunity from prosecution as a matter of law[10] because he met with members of a legislative committee to dis-

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handicapped children. 404 So. 2d at 1361-62; *see* Act of Jan. 4, 1975, Pub. L. No. 93-647, 88 Stat. 2337; Act of Sept. 7, 1976, Pub. L. No. 94-401, 90 Stat. 1215 (codified as amended at 20 U.S.C. §§ 1401, 1421, 1423, 1424) (1976 & Supp. III 1979) (comprehensive training programs set up to assist handicapped children and to encourage parental participation).

[4] The Developmental Learning Association (DLA) was organized in 1977 by the defendant and four other professionals as a corporation for profit. 404 So. 2d at 1362-63, 1363 n.4. DLA was designed to conduct educational and training assistance programs in a six-county area in Southeast Mississippi for 1281 children with learning disabilities or deficiencies or both in order to modify their behavior and enhance their motivation. *Id.* at 1362-63. Under the contract, DLA was to be paid $369,500 for its services. *Id.* at 1363-64.

[5] The defendant was DLA's attorney from its creation; he drew up and submitted the articles of incorporation to the Secretary of State for approval. *Id.* at 1363. The defendant was also actively engaged before, during, and after the contracting period with the State Department of Public Welfare. *Id.* at 1363-64. After the contract was approved by the legislature, the defendant submitted several statements for payment to the department and was given a check on each occasion. *Id.* at 1364, 1373 app. B. The defendant received a monthly salary of $2500, as well as additional compensation for legal fees and a $15,000 bonus for "services rendered." *Id.*

[6] Act of April 11, 1977, chs. 227, 228, 1977 Miss. Laws 362-64. The two appropriation bills, H.R. 1389 and 1390, were to take effect July 1, 1977, the beginning of the next fiscal year. 404 So. 2d at 1362, 1371 app. A.

[7] The defendant contended that House Bills 1389 and 1390 were mere appropriation bills that did not "authorize" the contract between the state and DLA. 404 So. 2d at 1365. Rather, the contract had already been authorized by Act of July 30, 1968, ch. 562, § 6, 1968 Miss. Laws 939, 943 (codified at MISS. CODE ANN. § 43-1-17 (1972)), the basic statute under which the state and federal governments cooperate on Title XX social programs. This statute was enacted eight years before the defendant became a state senator. 404 So. 2d at 1365.

[8] 404 So. 2d at 1365-69; *see supra* note 2.

[9] 404 So. 2d at 1367-68, 1368 n.12. The defendant argued that § 97-11-19 did not reasonably define the meaning of the phrase "indirect interest." 404 So. 2d at 1367.

[10] On this point, the defendant relied upon MISS. CODE ANN. § 5-1-25 (1972), which states, "A person sworn and examined as a witness before either house, without procurement or contrivance on his part, shall not be held to answer criminally, or be subject to any penalty or forfeiture for any fact or act touching which he is required to testify . . . ." 404 So. 2d at 1370.

cuss his guilt.[11] The Circuit Court of Harrison County found the defendant guilty as charged.[12] On appeal, the Mississippi Supreme Court, *held*, affirmed. A legislator is guilty of a misdemeanor if during his term of office or one year thereafter he has a direct interest in a contract for which the legislative body authorized appropriations. *Cassibry v. State*, 404 So. 2d 1360 (Miss. 1981).

A conflict of interest may be defined as a confrontation between the obligations of public office and the rewards offered by private pecuniary interests.[13] Such a conflict arises when a person occupies a public position and uses that position to further his own personal interests in disregard of the trust placed in him by the public.[14] Pursuant to the

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[11] 404 So. 2d at 1369-70. The Rules Committee voted unanimously to file a resolution of expulsion against the defendant, but in order to spare both the defendant and the legislature the trauma and publicity such a proceeding would engender, six senators agreed to meet privately with the defendant so as to give him the opportunity to take whatever action he felt appropriate. *Id.* at 1370.

[12] After the defendant was indicted by the grand jury of the Circuit Court of Harrison County for violating § 97-11-19, he entered a demurrer to his indictment, which was overruled at the trial. 404 So. 2d at 1365. By agreement, the jury was waived and the circuit judge found the defendant guilty as charged and fined him $739,000, double the amount of the contract price between DLA and the Department of Public Welfare. *Id.* The circuit judge reduced the fine to $45,000, which was the amount the defendant had received from DLA. *Id.* at 1365 & n.9, 1373 app. B. Also assigned as error on appeal was a refusal by the ciruit judge to allow the defendant to examine a written recorded interview given by the Commissioner of the State Department of Public Welfare to representatives from the Attorney General's Office who were investigating DLA. *Id.* at 1371.

[13] Generally, a conflict of interest exists when a public official has placed himself in a position where, because of some personal advantage to be gained, he finds it difficult, if not impossible, to act impartially and in the best interest of the public. Note, *Conflict of Interest: State Government Employees*, 47 VA. L. REV. 1034, 1034 n.1 (1961) (citing Minnesota Governor's Committee on Ethics in Government Report (1959)). Conflict of interest problems may arise in four contexts: (1) where a bargain occurs that exchanges some form of action by the official for an illegal reward; (2) where an official accepts an award for doing something that he was already bound to do; (3) where an official accepts payment for an act that he has a duty not to do; or (4) where an official utilizes legitimate discretion for improper reasons. Cranston, *Regulating Conflict of Interest of Public Officials: A Comparative Analysis*, 12 VAND. J. TRANSNAT'L L. 215, 219 (1979) (citing McMillan, *A Theory of Corruption*, 9 Soc. REV. 181 (1961)).

[14] *See, e.g.*, City of Coral Gables v. Weksler, 164 So. 2d 260, 263 (Fla. Dist. Ct. App. 1964). In balancing the public and private interests involved, some courts have held that officials owe an absolute duty of loyalty and fidelity to the public. *See, e.g.*, Village of Wheeling v. Stavros, 89 Ill. App. 3d 450, 411 N.E.2d 1067, 1069 (1980); Newton v. Demas, 107 N.J. Super. 346, 258 A.2d 376, 378 (1969); *see also* Norton v. Tallahassee Memorial Hosp., 511 F. Supp. 777, 781 (N.D. Fla. 1981) (public official should avoid any appearance of conflict). Furthermore, a conflict of interest has been found even though no evil motive or personal gain was involved. *See* Bushnell v. Superior Court, 102 Ariz. 309, 428 P.2d 987, 989 (1967). Other courts have not been as absolute and have instead

common law rules of trust, a duty was placed on a public servant to act solely in the interest of the public or cestui que trust.[15] This basic idea was adopted by the first Congress of the United States, which passed a law in 1789 prohibiting the Secretary of the Treasury from becoming involved in the public securities market.[16]

One of the earliest reported cases dealing with conflicts of interest in public contracts was a New York case, *Smith v. Albany*.[17] In 1869, the Albany Common Council appropriated $2500 for a Fourth of July celebration. Smith, who was a member of the council at the time, voted for the appropriation. Shortly thereafter he was hired to furnish horses and carriages for the festivities.[18] Noting that the transaction presented a "conflict of duties" for the plaintiff, the New York Commission of Appeals held the arrangement void as against public policy.[19] The court explained that the council member's own personal interest would not be allowed to stand in direct oppositon to the duty he owed his principal—the public.[20] A similar question at issue in *Lillard v. Freestone County*[21] was whether a Texas constitutional prohibition against legislators having any interest in contracts with the state[22] was violated when a legislator voted for a contract between himself and a

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attempted to balance the interest in preventing conflict of interest, on the one hand, and the respect for privacy in personal financial affairs, on the other. *See, e.g.*, Dwyer v. Kahn, 88 Misc. 2d 73, 387 N.Y.S.2d 535, 536 (Sup. Ct. 1976) (financial disclosure statute upheld where there was no unnecessary intrusion into public official's private lives); *see also* Greene v. State, 263 So. 2d 194, 196 (Fla. 1972) (election to public office on part-time basis and practicing law not a conflict of interests); Note, *Conflicts of Interest of State Legislators*, 76 HARV. L. REV. 1209, 1209-10 (1963) (courts should balance public and private interests when legislator is part-time official). See generally Note, *Conflicts of Interest of State and Local Legislators*, 55 IOWA L. REV. 450, 450-51 (1969), which discusses the need to have qualified people in public office and the reasons why so many qualified people do not seek public positions.

[15] Marsh v. Hanover, 113 N.H. 667, 313 A.2d 411, 414 (1973); Note, *supra* note 13, at 1034.

[16] Treasury Department Act of 1789, ch. 12, § 8, 1 Stat. 65, 67 (repealed 1908). Section 8 provided for removal of the Secretary of the Treasury for any violation or breach of the provisions of the section. *Id.*

[17] 61 N.Y. 444 (1875); *see* Comment, *Conflict of Interests and the Municipal Employee*, 20 BUFFALO L. REV. 487, 488-90 (1971) (analysis of *Smith v. Albany*).

[18] 61 N.Y. at 444.

[19] *Id.* at 447.

[20] *Id.* at 445.

[21] 23 Tex. Civ. App. 363, 57 S.W. 338 (1900).

[22] TEX. CONST. art. III, § 18 (1876) (amended 1968) provides in pertinent part: "[N]o Senator or Representative shall, during the term for which he was elected, be eligible to [sic] (1) any civil office of profit under this State which shall have been created, or the emoluments of which may have been increased, during such term . . . ."

county to print delinquent tax records.[23] The legislator contended that the constitutional prohibition only applied to the term in which the contract was authorized. Therefore, since he was not a member of the legislature when the delinquent tax law was passed, and since subsequent amendments to the law passed during his term did not constitute a reenactment of that law, then there was no conflict of interest.[24] The Texas Court of Civil Appeals rejected this argument. Even though the contract was authorized by an earlier legislature, the amendments to the delinquent tax law, passed in a later term of the legislature of which the defendant was a member, were sufficient to constitute a conflict of interest and render the contract void.[25] In attempting to deter these subtle forms of foul play, most jurisdictions have since developed statutes or constitutional provisions.[26] The most common statutory or

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[23] 57 S.W. at 338-40.

[24] *Id.* at 339.

[25] *Id.* at 340. The court noted that even though the change in the tax law was slight, the amendment was passed as a whole by the legislature, so the passage, in effect, amounted to a reauthorization of the law. *Id.*; *cf.* State v. Board of Educ., 389 P.2d 356, 360 (Okla. 1964) (construing constitutional prohibition similar to *Lillard* and to MISS. CONST. art. IV, § 109; school appropriation bill did not "authorize" contract with school teacher who was also legislator); Norbeck & Nicholson Co. v. State, 32 S.D. 189, 142 N.W. 847, 848 (1913) (constitutional prohibition almost identical to § 109 employed to invalidate contract where legislator was head of corporation contracted with). *But cf.* Berney v. Alexander, 42 Nev. 423, 178 P. 978, 979 (1919) (statute prohibiting legislators from contracting with legislature did not apply to legislator whose contract was authorized by an earlier legislature of which he was not a member); State *ex rel.* Maryland Casualty Co. v. State Highway Comm'n, 38 N.M. 482, 35 P.2d 308, 312 (1934) (compensation policy held not invalid though legislator had interest in policy, because prior statute authorized commission to take out such a policy); State *ex rel.* Baca v. Otero, 33 N.M. 310, 267 P. 68, 69 (1928) (legislator allowed to enter into school supervisor employment contract that was authorized by an appropriation bill passed during previous legislative session).

[26] *See, e.g.*, ARK. CONST. art. LIV, § 1 (prohibits official from being "in any way interested in contract"); DEL. CONST. art. XV, § 8 (no public officer to be interested in state printing contract); NEB. CONST. art. III, § 16 (no legislator to have direct interest in any contract authorized during his term or one year after term expires); OKLA. CONST. art. V, § 23 (no legislator to have direct or indirect interest in any contract authorized while legislator in office or within two years after expiration of term); S.D. CONST. art. III, § 12 (no legislator to have direct or indirect interest in any contract authorized while legislator in office or within one year after expiration thereof); TEX. CONST. art. III, § 18 (same but prohibition only applies to term of office); WYO. CONST. art. III, § 31 (no public officer to be interested, directly or indirectly, in state printing contracts); ARIZ. REV. STAT. ANN. § 38-503 (Supp. 1975-1981) (prohibits substantial interest by officer or relative in contract with the state); CAL. GOV'T CODE § 1090 (West 1980) (prohibits official from having a "financial interest" in contract); CONN. GEN. STAT. ANN. § 7-479 (West 1972) (allows municipalities, by ordinance or regulation, to prohibit municipal officers

constitutional provision prohibits officials from having either direct or indirect interests in public contracts.[27]

In 1907, the Mississippi Supreme Court had its first opportunity to construe Mississippi's general conflict of interest prohibition[28] in

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from being interested in contracts with municipality); D.C. CODE ANN. §§ 1-339, 1-1102 (1981) (contract void if contracting officer or mayor has an interest therein); HAWAII REV. STAT. § 84-15 (Supp. 1981) (prohibits official from having a "controlling interest" in contract); ILL. ANN. STAT. ch. 127, § 132.11-1 (Smith-Hurd 1981) (official forbidden to have "any direct pecuniary interest" in contract); LA. REV. STAT. ANN. § 42:1112 (West Supp. 1982) (official forbidden to have a "personal substantial economic interest" in contract); MD. ANN. CODE art. 40A, § 3-101 (Supp. 1981) (prohibits interest of official, his spouse, parent, minor child, brother or sister in contract); MONT. CODE ANN. § 2-2-201 (1981) (prohibits official from simply having "an interest" in state contract); NEB. REV. STAT. § 17-611 (1977) (no municipal officer to be interested, directly or indirectly, in contract when consideration for the contract is over $10,000); TENN. CODE ANN. §§ 12-4-101 to -102 (1980) (unlawful for public official to have direct or indirect interest in contract with government).

[27] *See, e.g.*, MICH. CONST. art. IV, § 10; W. VA. CONST. art VI, §§ 15, 34; KAN. STAT. ANN. § 46-132 (1973); KY. REV. STAT. ANN. § 45A.340 (Baldwin 1980); ME. REV. STAT. ANN. tit. 17, § 3104 (Supp. 1981); MISS. CODE ANN. § 97-11-19 (Supp. 1981); N.M. STAT. ANN. § 30-23-6 (1978); OKLA. STAT. ANN. tit. 21, § 344 (West 1951); S.D. CODIFIED LAWS ANN. § 3-16-7 (1980); TENN. CODE ANN. § 12-4-101 (1980); VT. STAT. ANN. tit. 3, § 204 (1972); WASH. REV. CODE ANN. § 42.20.010 (1972); WYO. STAT. § 6-8-508 (1977).

[28] The earliest Mississippi conflict of interest statute was adopted by the Act of Feb. 13, 1871, ch. 43, §§ 1-2, 1871 Miss. Laws 101 (codified at MISS. REV. CODE §§ 1390-1393 (1871)). This law prohibited members of the county boards of supervisors from having a direct or indirect interest in a contract with the county for the construction of certain public buildings. Anyone convicted of this offense could be fined between $100.99 and $500 or could be imprisoned in the county jail not less than one month. The offender would also be removed from office. The 1871 statute has been carried forward with only minor changes and is today codified at MISS. CODE ANN. §§ 19-13-1 to -5 (1972). The penalty is currently a fine of from $25 to $500 or imprisonment for up to six months or both, coupled with mandatory removal from office. *Id.* § 19-13-7. In 1892, another statute was enacted that prohibited any public officer or member of the legislature from being directly or indirectly interested in any contract with the state, or a district, county, city, town, or village thereof. Violation of this statute was a misdemeanor and the offender could be fined twice the amount of the contract or sentenced to not less than one month or more than one year in jail. MISS. ANN. CODE § 1229 (1892). This version of the statute was reenacted in MISS. CODE § 1305 (1906) and again in MISS. ANN. CODE § 1038 (Hemingway 1917). In 1930 two code sections were enacted to cover the conflict of interest area. Act of April 8, 1922, ch. 230, 1922 Miss. Laws 315 (codified at MISS. CODE ANN. § 1069 (1930)), and Act of April 12, 1924, ch. 238, 1924 Miss. Laws 332 (codified at MISS. CODE ANN. § 1079 (1930)). The first section provided for an election of remedies; either a civil or a criminal proceeding could be brought against the official. Under a civil proceeding, recovery would be limited to double the value of the contract. MISS. CODE ANN. § 1069 (1930). The second section provided that the criminal penalties set forth in § 1069 did not apply to certain officials who were officers or stockholders of banks bidding for the privilege of keeping as depositories the public funds where the bid was the highest

Noxubee County Hardware Co. v. City of Macon.[29] The hardware company sought to enjoin the city from buying certain merchandise from a member of the board of aldermen and alleged that such a purchase would violate section 109 of the Mississippi Constitution of 1890.[30] The city maintained that the needed merchandise was bought in the open market, and that since the secretary of the plaintiff hardware company was also a member of the board of aldermen, then the plaintiff was estopped from bringing suit.[31] The supreme court reversed a holding for the city and enjoined the sale.[32] After reaffirming the supremacy of the public interest,[33] the court stated that section 109 of the constitution would be construed to "prevent graft of every possible sort, and [to] secure the honest and clean administration of municipal affairs."[34] Furthermore, even if the board member acted in good faith, without fraud, and in ignorance of section 109's true meaning, the prohibition still applied.[35]

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and best one offered or where it was the only one offered. These sections were reenacted in *id.* §§ 2301-2302 (1942). The two sections were combined in *id.* § 97-11-19 (1972) with basically the same provisions. This statute has been altered slightly also to exempt the editor or employee of any newspaper in which legal notices are published. Act of Mar. 24, 1975, ch. 388, 1975 Miss. Laws 498 (codified at MISS. CODE ANN. § 97-11-19 (Supp. 1981)). For similar constitutional and statutory prohibitions against conflicts of interest in other states, see *supra* notes 26-27.

[29] 90 Miss. 636, 43 So. 304 (1907).

[30] *Id.* at 636-37, 43 So. at 304; *see supra* note 2. The plaintiff, a Macon hardware company, alleged that the city of Macon showed partiality toward a city alderman when it purchased from the alderman merchandise necessary for the electric light and water plant. The plaintiff argued that the same merchandise could have been purchased from its own hardware store at a cheaper price. 90 Miss. at 637, 43 So. at 304. The plaintiff further alleged that the city's partiality violated § 109 of the constitution and argued that an injunction should be granted to prevent future purchases. 90 Miss. at 636-37, 43 So. at 304.

[31] 90 Miss. at 637-38, 43 So. at 304. The city further argued that the superintendent of the waterworks purchased the needed merchandise without authorization or order by the board of aldermen and that the purchase was made on the open market after the plaintiff refused to extend credit to the city. *Id.* at 637, 43 So. at 304.

[32] *Id.* at 642, 43 So. at 305.

[33] The court noted that the constitutional provision in question was passed to protect the interests of all people and that the public interest superseded any private interests the two aldermen might have in the outcome of the litigation. Furthermore, whether one alderman could sell goods cheaper than the other and whether either was trying to gain a monopoly of the city's business was wholly immaterial in light of the constitutional prohibition. *Id.* at 642, 43 So. at 305.

[34] *Id.* at 640-41, 43 So. at 305. The court also advised that the two aldermen who were interested in merchandise contracts should resign if they wanted to compete legally for future contracts with the city. *Id.* at 641, 43 So. at 305.

[35] *Id.* at 641, 43 So. at 305.

The first recorded conviction in Mississippi for violating the conflict of interest laws occurred in *Treen v. State*.[36] A member of the Lamar County Board of Supervisors was indicted and convicted in the lower court for violating section 109 of the constitution and section 1305 of the Mississippi Code[37] because he was found to have contracted under an order passed by the board to inspect construction work on a courthouse.[38] The supreme court reversed the conviction on the grounds that the indictment was faulty,[39] and further noted that the order passed by the board of supervisors could not constitute a contract with the supervisor unless he had procured or consented and accepted benefits under the contract.[40] In *State ex rel. Stirling v. Board of Levee Commissioners*,[41] an attorney serving as levee commissioner in Coahoma County was appointed by the levee board to assist the board's regular attorney with an unusually heavy case load.[42] The commissioner did not procure or seek the job, and he retired from the board while the appointment was under consideration.[43] The supreme court, in denying the commissioner payment for his legal services, held that the contract was clearly within the prohibition of section 109 because of the commissioner's direct personal interest in the employment contract.[44]

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[36] 92 Miss. 756, 46 So. 252 (1908).

[37] *Id.* at 757-58, 46 So. at 252 (citing MISS. CODE § 1305 (1906) (codified as amended at MISS. CODE ANN. § 97-11-19 (1972)) and MISS. CONST. art. IV, § 109); *see supra* note 2 for text of both provisions.

[38] 92 Miss. at 757, 46 So. at 252. The supervisor was appointed by the board of supervisors to handle the inspection. This appointment was made without the supervisor's knowledge. *Id.*, 46 So. at 252.

[39] The indictment contained no charge that the supervisor had procured the contract, consented to it, or received any benefit under it. Thus, to uphold a conviction under the statute, the indictment, as the court noted, must charge some complicity by the defendant in obtaining the prohibited contract. *Id.* at 761, 46 So. at 253-54.

[40] *Id.*, 46 So. at 254.

[41] 96 Miss. 677, 51 So. 211 (1910).

[42] *Id.* at 684, 51 So. at 211.

[43] *Id.*, 51 So. at 211.

[44] *Id.* at 685, 51 So. at 211. The court mentioned that § 1305 of the Mississippi Code was identical to § 109 except for the penalty provision in the former. The court, however, without explanation, did not apply § 1305 to this case even though the commissioner was found to have a direct personal interest in his employment contract. 96 Miss. at 685, 51 So. at 211. The court also disregarded the fact that the contract was made in good faith, that the services performed were valuable to the board, and that the compensation to be paid was reasonable. *Id.* at 684, 51 So. at 211. Similarly, in 1925, the Mississippi Supreme Court permitted a state revenue agent to recover money that the Warren County Board of Supervisors had paid to one of its members pursuant to a county contract. The court again found that the contract was prohibited by § 109 because the board member

A constitutional provision similar to section 109 was applied in *Norbeck & Nicholson Co. v. State*,[45] to deny payment under a contract between the state and a corporation whose president was also a state senator.[46] The court based its decision on the principle that a public official was in a fiduciary relationship with the public[47] and could not, without violating public policy and the constitutional prohibition,[48] have any interest, direct or indirect, in any contract with the state.[49] The prohibition was thought necessary to prevent the private interests of a public official from interfering with his ability to act in the public's interest.[50] The court also dismissed as immaterial the fact that there was neither dishonesty nor moral turpitude, and that the state derived an advantage from the contract with the senator.[51]

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had had a direct interest in a county contract authorized by the board during the time he served as one of its members. Miller v. Tucker, 142 Miss. 146, 195, 105 So. 774, 783-84 (1925) (en banc) (per curiam).

And, in 1958, trustees of the Neshoba County Hospital were found to be in violation of the conflict of interest statute by selling certain supplies to the hospital. Golding v. Salter, 234 Miss. 567, 595-96, 107 So. 2d 348, 359-60 (1958).

The statute, however, was held not to apply where an indictment did not charge that the contract was authorized during the term for which the defendant city alderman was elected. State v. McClinton, 334 So. 2d 677, 679 (Miss. 1976).

[45] 32 S.D. 189, 142 N.W. 847 (1913).

[46] 142 N.W. at 848. In 1911, while Peter Norbeck was serving as a state senator, the South Dakota Legislature passed a law appropriating money to sink and equip an artesian well on the grounds of the state university. Later that year, Norbeck, on behalf of his corporation, contracted with the state board of regents to construct the well. A claim for payment was submitted upon completion of the work, but the state auditor refused to allow it on the ground that it was in conflict with the state constitution. *Id.* See *infra* note 48 for text of the constitutional prohibition.

[47] 142 N.W. at 849.

[48] S.D. CONST. art. III, § 12. This section states in pertinent part: "No member of the Legislature shall . . . during the term for which he shall have been elected, or within one year thereafter, be interested, directly or indirectly, in any contract with the state . . . ." *Id.*

[49] 142 N.W. at 848-49.

[50] *Id.* at 849; *see* State *ex rel.* Settles v. Board of Educ., 389 P.2d 356, 360 (Okla. 1964) (*Norbeck* quoted with approval; legislator-school teacher has conflict of interest if he is a member of the legislature when funds are appropriated for a year in which he has a teaching contract); Owen, *Conflicts of Interest of Public Officers and Employees*, 13 GA. ST. B.J. 64, 65 (1976) (public officers have fiduciary relationships with the public); Comment, *Legislative Bodies—Conflicts of Interest—Legislators Prohibited from Contracting with State*, 7 NAT. RESOURCES J. 296, 299 (*Norbeck* cited; New Mexico Attorney General's opinion regarding state conflicts of interest statute criticized).

[51] 142 N.W. at 849-50. The absolute denial of payment for services performed under a contract that is held void because it was tainted by a conflict of interest can work a hardship on those who have already supplied the services. *See* Note, *supra* note 13, at

The methods of enforcing compliance with conflict of interest statutes vary from state to state. Some states provide statutes with criminal sanctions,[52] while others are less severe,[53] and others have a remote or de minimis interest exception before the statute applies.[54] Also, some states have passed financial disclosure laws requiring the public official to reveal any potential or existing conflicts of interest that the official may have.[55] Other states, including Mississippi, have passed a code of ethics that usually provides a public official with a hearing before an ethics committee in order to protect the official from meritless conflicts of interest charges.[56]

1037-38 (absolute denial of quantum meruit seems harsh; attempt to vanquish all conflicts needs to be balanced with equitable principles).

[52] *See, e.g.*, KAN. STAT. ANN. §§ 21-4502, 75-4306 (1977); MISS. CODE ANN. § 97-11-19 (Supp. 1981) (see *supra* note 2 for text of statute). In 1974, the Mississippi Supreme Court outlined the penalties for violation of the state's conflict of interest statute in McMullen v. State, 298 So. 2d 708 (Miss. 1974). The mayor of the city of Newton had been charged with misconduct in office for approving city warrants payable to his hardware store for supplies and materials purchased by the city totaling $12,842.60. At the time of this hearing, the mayor had not been indicted or convicted of the charge. *Id.* at 710. The court held that any person found to be in violation of the statute would be subject to the penalites set forth in section 97-11-19 as well as removal from office. The court further noted that the official, once convicted of violating the statute, would not be allowed to succeed himself. 298 So. 2d at 710.

[53] *See, e.g.*, KY. REV. STAT. ANN. § 61.096 (Baldwin 1975) (contract in violation of statute is void); WYO. STAT. ANN. § 6-8-508 (1977) (fine of $100 to $5,000).

[54] A remote or de minimis interest statute generally designates certain activites that are *not* prohibited. *See, e.g.*, NEB. REV. STAT. § 17-611 (1977) (no public official may be directly or indirectly interested in public contract where consideration for contract exceeds $10,000); R.I. GEN. LAWS § 36-14-4(g) (Supp. 1980) (no legislator with 10% or more equity interest or $5,000 or greater cash value interest may enter into a contract with the state unless contract awarded in open, public process).

[55] *See, e.g.*, LA. REV. STAT. ANN. § 24:514 (West Supp. 1982); MISS. CODE ANN. §§ 24-2-25 to -27 (Supp. 1981). Advantages of financial disclosure include an increase in public confidence in government, a demonstration of the integrity of the vast majority of public officials, deterrence of potential conflicts, deterrence of persons who should not hold office from doing so, and more easily ascertainable evaluations of the performance by officers. Cranston, *supra* note 13, at 234-35. *See generally* NATIONAL MUNICIPAL LEAGUE, A MODEL STATE CONFLICT OF INTEREST AND FINANCIAL DISCLOSURE LAW (1979).

[56] *See, e.g.*, LA. REV. STAT. ANN. §§ 42:1144 to :1145 (West 1965); MISS. CODE ANN. §§ 25-4-5 to -23 (Supp. 1981). From 1961 to 1975 over 30 states passed a law creating a code of ethics or an ethics commission or both. Cooper, *Alabama Ethics Act—Milestone or Millstone*, 5 CUM.-SAM. L. REV. 183, 183 & nn.3-4 (1974-1975). *See generally* Stephens, *Alabama Ethics Cases*, 10 CUM. L. REV. 317, 318 & n.10 (1979-1980) (conflict of interest or ethics laws enacted in state after state). According to the Mississippi Legislature, the reasons for passing an ethics act are as follows:

> The legislature hereby declares it essential to the proper operation of democratic government . . . that public office not be used for private gain other

The courts have encountered difficulty in trying to determine whether a defendant has a direct or indirect interest as enunciated in the various prohibitions.[57] Direct interest prohibitions usually apply to situations where the public official owns or is a shareholder in a business or firm that is contracting with the government, or where the official is to be paid an identifiable proportionate share of the contract.[58] Interpreting what constitutes an indirect interest has also caused problems for the courts and has led to many incongruous results.[59] In

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than remuneration provided by law; that there be public confidence in the integrity of government; and that public officials be assisted in determination of conflicts of interest.

MISS. CODE ANN. § 25-4-1 (Supp. 1981).

[57] *See* Comment, *Conflict of Interest and the Municipal Employee*, 20 BUFFALO L. REV. 487, 487 (1971); Note, *Conflicts of Interest of State and Local Legislature*, 55 IOWA L. REV. 450, 453 (1969); *cf.* Yetman v. Naumann, 16 Ariz. App. 314, 492 P.2d 1252, 1255 (1972) (term "subtantial interest" refers to pecuniary or proprietary interest where person will gain or lose something; not to general sympathy, feelings, or bias); Panozzo v. City of Rockford, 306 Ill. App. 443, 28 N.E.2d 748, 754 (1940) (same); Kennedy & Beck, *Interest of Public Officers in Contracts Prohibited by Law*, 28 S. CAL. L. REV. 335, 342 (1955) (interest common to all not a prohibited interest). Mississippi Attorney General Bill Allain has said that the Mississippi Supreme Court should give a definitive ruling on what constitutes a conflict of interest. Sun Herald (Biloxi), Sept. 7, 1980, at A-1, col. 4. The attorney general also stated that as long as the court did not define "indirect interest," an old attorney general's office opinion, which required a legislator to determine for himself if he had an indirect interest would apply. *Id.*

[58] Most courts agree that any present immediate pecuniary interest is within the prohibited "direct interest." *See, e.g.*, Atherton v. City of Concord, 109 N.H. 164, 245 A.2d 387, 388-89 (1968), *overruled on other grounds in* Totty v. Grantham Planning Bd., 120 N.H. 388, 415 A.2d 687, 688 (1980); *see also* Note, *supra* note 13, at 1045 (private benefit must be present, personal, and pecuniary to fall within prohibition).

Some courts maintain that the financial gain need only be potential. *See, e.g.*, United States v. Mississippi Valley Generating Co., 364 U.S. 520, 555-57 (1961) (reasonable expectation of profit is sufficient); People v. Savaiano, 66 Ill. 2d 7, 359 N.E.2d 475, 479 (1976) (consummation of contract not necessary to find violation); Yonkers Bus, Inc. v Maltbie, 23 N.Y.S.2d 87, 91 (Sup. Ct.), *aff'd*, 260 A.D. 893, 28 N.Y.S.2d 91 (App. Div. 1940) (fruition of interest need not be immediate). The North Dakota court has held that the official must be a "substantial" stockholder to be in violation of the conflict of interest statute. State v. Robinson, 71 N.D. 463, 2 N.W.2d 183, 189 (1942). Other states permit the officer to participate in the award of a contract if he is a shareholder of less than a certain percentage of the stock in the firm. *See, e.g.*, CAL. GOV'T CODE § 1091.5(a) (West 1980) (3%); ILL. ANN. STAT. ch. 127, § 132.11-1 (Smith-Hurd 1981) (7½% or 15% together with spouse); N.Y. PUB. OFF. LAW § 73(3) (McKinney 1952 & Supp. 1981); *see also* B. MANNING, FEDERAL CONFLICT OF INTEREST LAW 126-27 (1964) (effect of de minimis interest in shareholdings is difficult to ascertain); Eisenberg, *Conflicts of Interest Situations and Remedies*, 13 RUT. L. REV. 666, 687 (1959) (question is how much is necessary to jeopardize public interest).

[59] *Compare* State v. Bennett, 213 Wis. 456, 252 N.W. 298, 302-303 (1934) (contract

Bouchelle v. State Highway Commission,[60] the Alabama Highway Commission approved locating a highway in the vicinity of the property of one of the commissioners.[61] Taxpayers from two counties brought suit to enjoin the highway commission from entering into a contract for the construction of the highway,[62] claiming that the commissioner had an indirect interest in the contract in violation of a state statute.[63] The Alabama Supreme Court held that the commissioner had no interest, direct or indirect, in the contract because most of the highway had already been built before he became a member of the commission and the commissioner derived no more benefit from the

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benefiting engineer employed by city but not acting in his official capacity was valid) *with* State *ex rel.* Stirling v. Board of Levee Comm'rs, 96 Miss. 677, 684-85, 51 So. 211, 211 (1910) (contract between board and a member was prohibited even though the member was not active). *Compare* Thompson v. District Bd. of Moorland, 252 Mich. 629, 233 N.W. 439, 440 (1930) (school district officer not "interested" in wife's teaching contract with district) *with* Githens v. Butler County, 350 Mo. 295, 165 S.W.2d 650, 652-53 (1942) (county court judge "interested" in wife's contract to purchase realty from county). *Compare* Moody v. Shuffleton, 203 Cal. 100, 262 P. 1095, 1097 (1928) (supervisor holding chattel mortgage on newspaper "interested" in contract for county printing) *with* Collingsworth v. City of Catlettsburg, 236 Ky. 194, 32 S.W.2d 982, 983 (1930) (council member who loaned money to corporation not "interested" in city contract with the corporation). *Compare* Cunningham v. Union High School Dist., 131 Wash. 41, 228 P. 855, 856 (1924) (contract awarded to sons of directors of school district not illegal) *with* Rankin v. Board of Educ., 135 N.J.L. 299, 51 A.2d 194, 196-97 (1947) (board of education contract awarded to relative of board member was illegal). *Compare* United States v. McMillan, 114 F. Supp. 638, 642-43 (D.D.C. 1953) (absence of fraudulent intent warranted acquittal of defendant) *with* Commonwealth *ex rel.* Kutzl v. Witman, 217 Pa. 411, 66 A. 986, 988 (1907) (question of fraudulent intent irrelevant). *Compare* Heffernen v. City of Green Bay, 266 Wis. 534, 64 N.W.2d 216, 222 (1954) (construction contract with city legal where alderman resigned employment when his employer submitted bid) *with* Stigall v. City of Taft, 58 Cal. 2d 565, 375 P.2d 289, 292, 25 Cal. Rptr. 441, 444 (1962) (city plumbing contract invalid where council member owning more than three per cent interest in plumbing company resigned just prior to acceptance of company's bid). *See generally* Annot., 74 A.L.R. 792 (1931) (contrary decisions regarding kinship as disqualifying interest); Annot., 73 A.L.R. 1352 (1931) (contrary decisions regarding whether public officer who is creditor of party to a public contract is "interested" in the transaction).

[60] 211 Ala. 474, 100 So. 884 (1924).

[61] 100 So. at 888. State law required the state highway commission to "locate, construct and maintain highways . . . [and] to connect each county seat with the county seat of the adjoining county by the most direct and most feasible route by a permament road . . . ." *Id.* at 885.

[62] The controversy arose over whether the route selected by the highway commission was the most direct and most feasible. The taxpayer plaintiffs were seeking to have the connecting highway located in another part of the county. *Id.*

[63] *Id.* at 888 (citing Act of 1923, § 11½, 1923 Ala. Acts 375 (codified as amended at ALA. CODE § 23-1-58 (1975)) (prohibits members of highway department from being interested, directly or indirectly, in contract with state)).

highway than anyone else.[64] In *Hobbs, Wall & Co. v. Moran*,[65] a member of the city council of Crescent City, California, who was also a salaried manager of a mercantile business from which the city bought supplies, voted to pay claims submitted to the council by the business.[66] The city treasurer refused to pay these claims contending that the councilman-manager had an indirect interest in the transaction that was a violation of a local statute.[67] The court held for the city treasurer, reasoning that any interest by a public official in a contract with the city could compromise the official's ability to act with absolute loyalty and allegiance towards the public.[68] Thus, the local statutory prohibition applied even though the councilman-manager owned no stock in the business and had no direct pecuniary interest in it.[69] In attempt-

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[64] The court noted that the plaintiffs appeared to assert that the commissioner would have an indirect personal and financial interest in any contract for highway construction or maintenance in Sumter County merely because he owned in the county large tracts of land, which would appreciate in value as a result of the proposed location. The court held, however, that while in some instances this might constitute an interest in the *location* of the highway, it was not a direct or indirect interest in a *contract* or agreement for its construction or maintenance. 100 So. at 888-89 (1924). In People v. Simpkins, 45 Ill. App. 3d 202, 359 N.E.2d 828, 832-33 (1977), the mayor of Hurst, Illinois, was charged with "having an interest in a contract" in violation of an Illinois conflict of interest statute. The charges stemmed from the fact that the mayor's wife was employed as clerk of the Hurst Water Department after the mayor took office and her employment continued during his term. The court held that without more specific particularization of the type of pecuniary interest the mayor was alleged to have in his wife's employment, the indictment did not charge the mayor with anything other than holding the office of mayor while his wife worked for his city, a "fact undoubtedly known to the citizens of Hurst." 359 N.E.2d at 832-33.

[65] 109 Cal. App. 316, 293 P. 145 (Dist. Ct. App. 1930).

[66] 293 P. at 146.

[67] *Id.* at 146-47. The statute declared that a contract to furnish supplies to a city or town would be void where an officer had a direct or indirect interest in that transaction. *Id.* at 147.

[68] *Id.* at 146-47. The court further elaborated that it would not resort to fine distinctions in order to determine what facts would establish an indirect interest on the part of a public official. *Id.* at 146.

[69] *Id.* at 147. In United States v. Mississippi Valley Generating Co., 364 U.S. 520 (1961), Mississippi Valley sued the United States to recover costs and damages incurred under a government-terminated contract. The United States contended that the contract was unenforceable because during contract negotiations the government had been represented by an unpaid part-time consultant to the Budget Bureau who was concurrently an officer of an investment banking company that was expected to profit from the transaction. *Id.* at 523-49. The Supreme Court held that the consultant was "indirectly interested" in the contract since he not only shared in the profits of his company but also received a bonus for any business that he brought to the firm. *Id.* The transaction thus violated Act of June 25, 1948, ch. 645, 62 Stat. 703 (repealed 1962), a federal conflict of

ing to differentiate direct and indirect interests, courts have tended to look for affirmative factors that show that a conflict of interest exists and have dismissed as irrelevant any negative factors showing an absence of such a conflict unless the negative factors outweigh the affirmative factors.[70]

Because many of the conflict of interest statutes contain penal sanctions,[71] the courts have required that the statutes clearly define prohibited conduct so that public officials may avoid any acts that might lead to liability.[72] In *Jordan v. DeGeorge*,[73] an immigration act was alleged to be unconstitutional because the phrase "crime involving moral turpitude" as used in the act was vague.[74] The United States Supreme Court, in upholding a deportation order under the challenged

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interest statute that prohibited federal agents and officers from having a direct or indirect interest in the pecuniary profits of a corporation that contracted with the federal government. 364 U.S. at 548-62. The Court therefore held the contract unenforceable. *Id.* at 563-66. For examples of other federal statutes dealing with interests in government contracts, see 18 U.S.C. § 208 (1976), *amended by* 18 U.S.C. § 203 (Supp. III 1979) (prohibiting government employees from having personal financial interest in various transactions); 41 U.S.C. § 22 (1976) (prohibiting members of Congress from having an interest in any contract or agreement with the United States).

[70] *See* Note, *The Doctrine of Conflicting Interests Applied to Municipal Officers in New Jersey*, 12 RUT. L. REV. 582, 584-86 (1958).

[71] *See supra* note 52 and accompanying text. Another issue involved in suits dealing with conflicts of interest has been the question of whether to grant a government official immunity from prosecution for his violation of the conflict of interest laws. The Mississippi Supreme Court has faced this issue several times. For example, in State v. Billups, 179 Miss. 352, 174 So. 50 (1937), the court held that the defendant, who was indicted on a charge of conspiring to defraud the state of gasoline taxes, was entitled to immunity from prosecution under Act of Mar. 3, 1876, ch. 156, 1876 Miss. Laws 265 (codified at MISS. CODE ANN. § 5340 (1930) (current version at MISS. CODE ANN. § 5-1-25 (1972)), because he voluntarily appeared without contrivance in front of a legislative committee. 179 Miss. at 363-64, 174 So. at 51; *see supra* note 10. In Wheat v. State, 201 Miss. 890, 30 So. 2d 84 (1947), an employee of the Motor Vehicle Commission who had embezzled funds was held to be immune from prosecution because he was compelled to testify, and that testimony established the crime. *Id.* at 899-902, 30 So. 2d at 86-88. And in Kellum v. State, 194 So. 2d 492 (Miss. 1967), the court granted immunity to a defendant who had attempted to sell forged bonds because his appearance in front of a legislative committee, though without a formal summons, was sufficient to allow the claim for immunity. *Id.* at 493.

[72] Under the fourteenth amendment to the Constitution, a person cannot be deprived of his liberty or property without due process of law, which requires a reasonably ascertainable standard of guilt. Connally v. General Const. Co., 269 U.S. 385, 390 (1926).

[73] 341 U.S. 223 (1951).

[74] *Id.* at 229. A deportation proceeding was initiated against an alien who had twice violated the tax laws by attempting to evade payment of taxes on the sale of alcohol. *Id.* at 224-25.

act, enunciated a test for vagueness that requires that "the language [of the statute] convey sufficiently definite warning as to the proscribed conduct when measured by common understanding and practices."[75] The Court found that the phrase was sufficiently certain and that any doubt about the adequacy of the test in less obvious cases was not a sufficient reason to render the statute in question unconstitutionally vague.[76] Similarly, in *Roth v. United States*,[77] the Court stated that a lack of precision in a state statute that made it unlawful to keep or sell "obscene and indecent" materials was not in itself offensive to due process requirements[78] and that "the Constitution does not require impossible standards."[79] Following similar reasoning, the Louisiana Supreme Court invalidated that state's conflict of interest statute in

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[75] *Id.* at 231-32. The Court further noted that criminal statutes that fail to provide adequate notice of the criminal nature of an act violate the due process requirements of the fourteenth amendment. *Id.* at 230.

[76] *Id.* at 232. The Court found that crimes that contained an element of fraud had always been regarded as involving moral turpitude. *Id.* In dissent, Justice Jackson reasoned that the majority had applied the wrong test for vagueness and should have instead used the test formulated to gauge whether legislation was so vague that people of common intelligence would be forced to guess at the legislation's meaning and would disagree as to its application. *Id.* at 244 (Jackson, J., dissenting). By using this "common intelligence test," Justice Jackson found that the phrase "crime involving moral turpitude" was so vague that the phrase required judges to guess and disagree as to the phrase's meaning and thus the statute should have been declared unconstitutional. *Id.* at 244-45. In Lindberg v. Benson, 70 N.W.2d 42 (N.D. 1955), the North Dakota Supreme Court upheld a state statute prohibiting legislators and their spouses from performing work for or supplying services or supplies to the state, and rejected the challenge that the statute violated the fourteenth amendment's equal protection clause. *Id.* at 45-47. The *Lindberg* court noted that statutes are presumed constitutional, and constructions that render a statute's constitutionality doubtful should be avoided where reasonably possible. *Id.*

[77] 354 U.S. 476 (1957).

[78] *Id.* at 491-92.

[79] *Id.* at 491 (quoting United States v. Petrillo, 332 U.S. 1, 7-8 (1947)). The Court also stated that marginal cases might arise making it difficult to draw the line as to where a particular fact situation falls but that this was not a sufficient reason to hold a statute defining criminal offenses ambiguous. 354 U.S. at 491. The Court has applied this analysis in numerous other due process cases. *See, e.g.*, Rose v. Locke, 423 U.S. 48, 50 (1975) (statute proscribing "crimes against nature" not vague); Gooding v. Wilson, 405 U.S. 518, 520 (1972) (statute prohibiting "opprobrious words or abusive language" held to be unconstitutionally vague); Rowan v. United States Post Office Dep't, 397 U.S. 728, 738-40 (1970) (statute "fatally vague" when it does not give fair warning of the nature of the proscribed conduct; statute allowing for prohibition of receipt in mail of "arousing" material upheld); Baggett v. Bullit, 377 U.S. 360, 366-68 (1964) (statute requiring teachers to swear that they are not "subversive persons" held to be void for vagueness).

State v. Murtes.[80] Murtes was indicted under the Louisiana conflict of interest statute because he was a state legislator as well as a salaried employee of a paint company that sold supplies to the State Highway Department.[81] The supreme court upheld a judgment quashing an indictment against the legislator, because the phrase "in any way interested" as used in the statute was too general, broad, and vague.[82] In declaring the statute unconstitutional, the court reasoned that the statute did not provide an adequate criterion for distinguishing between legal and illegal conduct. Thus, a person of ordinary intelligence would not know whether his conduct was prohibited or permitted, especially in borderline cases.[83]

In the instant case, the court stated that the appropriations bills pertained to single subjects rather than to general financing.[84] Since

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[80] 232 La. 486, 94 So. 2d 446 (1957). The Grand Jury of East Baton Rouge Parish returned an indictment against Murtes, a state legislator, charging him with being interested in a contract to furnish paint to the Department of Highways. Murtes was employed on a commission basis by the company that received the paint contract. 94 So. 2d at 446-47.

[81] *Id.* (construing LA. REV. STAT. ANN. § 48:422 (West 1951), *amended by* LA. REV. STAT. ANN. § 48:422 (West Supp. 1982)). Said statute provides in pertinent part:

> [N]o member of the legislature or officer of the executive department of the state shall be in any way interested in any contract for the building or improving of any public work coming under the supervision of the Department of Transportation and Development or in any contract for the furnishing of any material or supplies of any kind to be used in connection therewith, nor shall any such member or officer receive any gratuity, commission, or payment of any sort as compensation for the procurement of any such contract.

LA. REV. STAT. ANN. § 48:422 (West Supp. 1982). The statute provides, however, that public officers who are also licensed contractors may bid on public contracts and be awarded such contracts on a competitive basis. *Id.*

[82] 94 So. 2d at 448. The court also held that the word "interested" was subject to many various meanings ranging from financial interest to civic-mindedness, and thus the statute's failure to define "interested" rendered the statute void. *Id.* at 447.

[83] *Id.* at 448. The court noted that a criminal statute was invalid if it failed to define accurately and specifically the offense so that a person of ordinary intelligence would know whether his conduct was on one side or the other of the borderline of propriety. *But see supra* note 79.

[84] Cassibry v. State, 404 So. 2d 1360, 1365-67 (Miss. 1981). The court noted that the difference between general appropriation bills and single subject appropriation bills was spelled out in § 69 of the Mississippi Constitution, which states:

> General appropriation bills shall contain only the appropriations to defray the ordinary expenses of the executive, legislative, and judicial departments of the government; to pay interest on state bonds, and to support the common schools. All other appropriations shall be made by separate bills, each embracing but one subject. Legislation shall not be engrafted on the appropriation bills, but the same may prescribe the conditions on which the money may be

the enacting clause of each bill incorporated the style of the laws of the state,[85] and the passage of these appropriations bills was required before funds could be expended under the contract between the state agency[86] and the corporation,[87] the appropriations bills were laws that "authorized the contract" within the meaning of section 97-11-19.[88] Furthermore, the contract was authorized during the defendant's term of office,[89] and the defendant's compensation from the corporation was dependent solely upon payments made under the contract.[90] Thus, the defendant had a direct interest in the contract[91] and was guilty of a misdemeanor for violating section 97-11-19.[92] In response to the vagueness defense, the court held that this defense was relevant only to cases where the phrase "indirect interest" would engender confusion.[93] Since the defendant had a direct rather than an indirect interest,[94] then the argument that section 97-11-19 was unconstitutionally vague, for failing to offer reasonable guidelines as to the extent of the indirect interest prohibition, was irrelevant.[95] Finally, the court concluded that since the defendant did not appear formally and officially before the legislature or any investigating committee to discuss his illegal conduct,[96] and

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drawn, and for what purpose paid.

MISS. CONST. art. IV, § 69. For a definition and discussion of appropriations, see State *ex rel.* Kurz v. Lee, 121 Fla. 360, 163 So. 859, 868 (1935); 81A C.J.S. *States* § 230 (1970). *See supra* note 25 and text accompanying notes 21-25.

[85] 404 So. 2d at 1365-66. Section 56 of the Mississippi Constitution states, "The style of the laws of the state shall be: 'Be it enacted by the legislature of the state of Mississippi.' " MISS. CONST. art. IV, § 56.

[86] 404 So. 2d at 1366; *see supra* note 3.

[87] 404 So. 2d at 1366; *see supra* note 4.

[88] 404 So. 2d at 1365-67. The court held that the fact that House Bills 1389 and 1390 were approprations bills did not prevent them from being laws as well. 404 So. 2d at 1365.

[89] 404 So. 2d at 1365; *see supra* notes 1, 7.

[90] 404 So. 2d at 1367. The court determined that the compensation test would be accurate for deciding whether an official had a direct interest in a contract with the state. *Id.* The compensation test asks whether or not the official's compensation depends upon payment being made under the contract. *Id.* The court also stated that a violation of the public trust occurred because the defendant favored DLA, and his personal compensation under the contract, over the people of the state. *Id.; see supra* note 5.

[91] 404 So. 2d at 1367; *see supra* notes 5, 58 and accompanying text.

[92] 404 So. 2d at 1368-69; *see supra* note 2.

[93] 404 So. 2d at 1367. If the vague portion of the statute is not applicable to a given defendant, then such defendant generally has no standing to challenge the statute's constitutionality. Broadrick v. Oklahoma, 413 U.S. 601, 610-13 (1973).

[94] 404 So. 2d at 1367.

[95] *Id.*; *see supra* notes 72, 76, 79 and accompanying text.

[96] 404 So. 2d at 1369-71; *see supra* notes 10-11, 71.

the defendant was not sworn to testify in front of either body,[97] then the defendant could not be granted immunity from prosecution[98] and, thus, his misdemeanor conviction must stand.[99]

The court's decision in the instant case is a correct one since the Mississippi conflict of interest statute was not vague as it applied to the defendant. Case law has repeatedly construed the phrase "direct interest" to include any immediate pecuniary benefit,[100] and, thus, the defendant was afforded reasonable notice of the proscribed conduct. The decision, however, left many questions unanswered, especially in the court's discussion of the meaning of direct and indirect interests. The court had the opportunity to interpret and explain what constitutes a conflict of interest within the meaning of section 97-11-19,[101] but declined to accept this challenge. Even though a direct interest test was formulated,[102] the court failed to give any guidelines as to what conduct would be acceptable. All the court said was that the defendant "passed" the test[103] by scoring a "bull's eye."[104] The court should have offered a more definitive explanation that would enable a public official to gauge, by the use of reasonable guidelines, whether he has a direct interest in a contract with the state.

Additionally, the "compensation test"[105] for a direct interest enunciated in the decision, though adequate for the instant case, could have a far reaching impact on those officials who receive some compensation

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[97] 404 So. 2d at 1370; *see supra* note 10. The court further noted that even though an official may appear voluntarily in front of an investigative body, once the official is duly sworn to testify, then his conduct is no longer controlled by his own will and he can be compelled to testify, or subject himself to contempt. 404 So. 2d at 1370.

[98] 404 So. 2d at 1370-71. The court concluded that since the defendant met privately with six senators, a meeting that all knew would be emotional, and since there was no investigation of any kind because the defendant was never sworn to testify, nor was a stenographer present, nor were any minutes made, and since there was no perfunctory formality associated with the meeting, then the defendant was not entitled to a grant of immunity. *Id.*

[99] *Id.* at 1371. The court also held that since a trial judge should be afforded very broad discretion in deciding whether to allow a defendant to examine statements made by a prosecuting witness, and since such a statement in the present case did not contain any information favorable to the defendant that had not already been revealed at trial, and since the testimony of the witnesses substantially complied with the statement, then there was no error, and the argument failed for lack of merit. *Id.*; *see supra* note 12.

[100] *See supra* note 58.

[101] *See supra* notes 2, 57.

[102] *See supra* notes 58, 90 and accompanying text.

[103] 404 So. 2d at 1367.

[104] *Id.* at 1368.

[105] *See supra* note 90 and accompanying text.

under a government contract, albeit a very small amount. The civil or criminal penalties such an official would face are harsh in relation to the compensation received. The de minimis or remote interest statutes[106] reflect a recognition of this problem and are an attempt to deal with the impracticality behind a strict demand for all public officials to have virtually no interest in government contracts.[107] The need for honesty in government must be balanced against the legitimacy of public officials having private interests.[108] Otherwise, strict "no interest" statutes like section 97-11-19[109] could effectively deter qualified people with expertise in their respective fields from entering public office[110] for fear that any private interest could result in a conviction for having a conflict of interest.

Furthermore, the court should not have dismissed a discussion of indirect interests as irrelevant.[111] "Indirect interest" could be a catch-all prohibition applicable to any interest not determined by the court or legislature to be direct. A legislator could theoretically have an indirect interest in any legislation. An indirect interest may result from merely authorizing a highway on which the legislator drives or passing a contract that ultimately creates jobs for some of the legislator's electorate.

Because of the uncertainty and the potential harshness that could result from "passing" the court's direct interest test or failing it and remaining subject to a claim for having an indirect interest, reasonable guidelines must be implemented to enable public officials to avoid this quagmire. Such guidelines should include explicit definitions of direct and indirect interests, a de minimis interest exception, a financial disclosure law,[112] and a law creating an ethics commission.[113] The Mississippi Legislature has started this auspicious process by passing both a financial disclosure law[114] and a law establishing an ethics commission to hear complaints against legislators who may have a conflict of inter-

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[106] *See supra* note 54 and accompanying text.

[107] *See supra* note 51 and accompanying text. Section 97-11-19 is very strict because a legislator can be convicted for having a conflict of interest even though he does not attempt to procure or vote on any legislation in which he might have a direct or indirect interest. Furthermore, even though a legislator is not present when a vote is taken, he may still be charged with a violation of § 97-11-19.

[108] *See supra* note 14.

[109] *See supra* notes 2, 52.

[110] *See* Note, *supra* note 14, at 451.

[111] *See supra* note 95 and accompanying text.

[112] *See supra* note 55 and accompanying text.

[113] *See supra* note 56 and accompanying text.

[114] *See supra* note 55.

est.[115] The legislature should continue to aid in the process of attempting to clarify conflicts of interest by amending section 97-11-19 with clear definitive statements specifying what direct and indirect interests are and by adding a de minimis interest exception. Until such legislation is passed, however, the court should, if and when next presented with a conflicts of interest case, interpret section 97-11-19 in such a way that workable guidelines are derived from the meaning of that section that will offer a public official some tangible criteria for avoiding any potential conflict of interest. These types of actions, balanced with equitable and salutary principles, will lead to guidelines for conduct that will enable qualified people to serve in public office without violating the public trust.

Susan Denise Morgan Guerieri
George Mitchell Simmerman, Jr.

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[115] *See supra* note 56 and accompanying text.

Constitutional Law—First Amendment—Attorney Advertising That Is Not False, Misleading, or Deceptive Is a Protected Form of Commercial Speech

Plaintiff, the Mississippi State Bar Association,[1] filed a formal complaint seeking disciplinary action alleging that defendant, William E. McLellan,[2] had violated certain sections of the Mississippi Code of Professional Responsibility[3] by causing an advertisement to be published in the "Yellow Pages" of the Jackson, Mississippi, telephone directory.[4] Plaintiff contended that defendant's advertisement violated three sections of the Code of Professional Responsibility.[5] Defendant

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[1] A complaint was filed by the Committee on Complaints of the Mississippi State Bar Association. McLellan v. Mississippi State Bar Ass'n, 413 So. 2d 705, 705 (Miss. 1982).

[2] The defendant, a member of the Mississippi State Bar, *id.* at 705, practiced law in Jackson, Mississippi. *Id.* at 709 app. I.

[3] *Id.* at 705. Mississippi Code of Professional Responsibility DR 2-101, 2-102 (1977). DR 2-101, in relevant part, prohibits statements of self-praise and prohibits advertisements in most forms of media publication. DR 2-102, in relevant part, restricts the use of professional notices, limits telephone directory listings to name, address, and telephone number, and restricts newspaper advertisements by attorneys to name, address, telephone number, routine legal services, and the fee for those services. *See infra* note 5.

[4] 413 So. 2d at 705. Defendant published an advertisement in the "Yellow Pages" stating certain hours during which he was available for consultation, that the first consultation was free, that he was licensed to practice in Mississippi, and his name, address, and telephone number. *Id.* at 709 app. I.

[5] *Id.* at 705-06. The three sections of the Code of Professional Responsibility involved in this case consist of five specific subsections. The first of these subsections, Mississippi Code of Professional Responsibility DR 2-101[A] (1977), prohibits a lawyer from using "any form of public communication that contains professionally self-laudatory statements calculated to attract lay clients."

The second subsection prohibits a lawyer from advertising "through newspaper (except as provided in DR 2-102[A] [7] and [8]) or magazine, advertisements, radio or television announcements, display advertisements in city or telephone directories or other means of commercial publicity." *Id.* DR 2-101[B].

The third subsection involved in this case, DR 2-102[A], provides that "professional cards, professional announcement cards, office signs, letterheads, telephone directory listings, law lists, legal directory listings, or similar professional notices or devices" may only be used if they are presented in a "dignified form."

The fourth subsection establishes that a listing in a telephone directory may only provide "the name of the lawyer or law firm, the fact that he is a lawyer, addresses, and telephone numbers," and that"[t]he listing shall not be in distinctive form or type." *Id.* DR 2-102[A][5].

The last subsection involved in this case, DR 2-102[A][8], provides that an adver-

admitted that the advertisement was published,[6] but claimed that if the advertisement were found to be prohibited by the Code of Professional Responsibility, the relevant sections of the Code were unconstitutional.[7] The Complaint Tribunal that heard the case ruled against the defendant.[8] On appeal, the Mississippi Supreme Court, *held,* reversed. Where an advertisement by an attorney in the "Yellow Pages" of a telephone directory is not likely to be misleading or deceptive, and similar advertisements have not been deceptive in the past, such advertisement is protected by the first amendment to the Constitution and may not be prohibited. *McLellan v. Mississippi State Bar Association,* 413 So. 2d 705 (Miss. 1982).

The first restrictions on advertising by members of the legal profession developed from principles established in ancient Greek and Roman civilizations.[9] In both the Greek and Roman cultures, litigation was conducted with only the judge and the opposing parties present, and any participation by legal representatives or other persons not directly involved in the conflict was seldom allowed.[10] This notion fluorished in England during the Middle Ages,[11] and when Christianity be-

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tisement in a newspaper by an attorney may consist of only the "[n]ame, including name of law firm, office address and telephone number, one or more routine legal services, as defined herein, which are offered and the fixed fee to be charged therefor," and that "[s]aid notice may also include the names of lawyers in the firm."

[6] 413 So. 2d at 706.

[7] *Id.* Specifically, defendant claimed that DR 2-102[A] was unconstitutional because of its requirement that advertisements contain only the name of the attorney, name of the firm, address, and telephone number. 413 So. 2d at 706; *see supra* note 5.

[8] 413 So. 2d at 705. The Complaint Tribunal held that defendant had violated three sections of the Code of Professional Responsibility: DR 2-101[A], DR 2-101[B], and DR 2-102[A]. 413 So. 2d at 706; *see supra* note 5.

[9] Francis & Johnson, *The Emperor's Old Clothes: Piercing the Bar's Ethical Veil,* 13 WILLAMETTE L.J. 221, 222 (1977); *see* Radin, *Maintenance by Champerty,* 24 CALIF. L. REV. 48, 48 (1935).

[10] Radin, *supra* note 9, at 48. Attempts by third parties to participate in proceedings in which they were not directly involved were disfavored because of potential harm to others and potential misuse of the court system. Francis & Johnson, *supra* note 9, at 222; *see also* Zimroth, *Group Legal Services and the Constitution,* 76 YALE L.J. 966, 969 (1967) (historical restrictions on participation by disinterested third parties in lawsuits).

[11] Radin, *supra* note 9, at 48. In medieval England, certain forms of interference with legal proceedings were punishable offenses. These offenses included: maintenance, which has been defined as "[a]n officious intermeddling in a suit which in no way belongs to one, by maintaining or assisting either party, with money or otherwise, to prosecute or defend it," BLACK'S LAW DICTIONARY 860 (5th ed. 1979); champerty, which is "[a] bargain by a stranger with a party to a suit, by which such third person undertakes to carry on the litigation at his own cost and risk, in consideration of receiving, if successful, a part of the proceeds or subject sought to be recovered," *id.* at 209; and barratry, which has

came widespread in that country the concept of the lawsuit itself was disfavored.[12] During the early development of English law, the legal system discouraged competition between members of the legal profession.[13] In addition, the concept of attorney advertising was held in contempt.[14]

These English attitudes against advertising and solicitation by lawyers influenced American common law and were set forth in statutes in some jurisdictions.[15] In 1887, various traditional rules were condensed into a code of ethics by the Alabama State Bar Association.[16] This code provided the basis for the Canons of Professional Ethics

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been defined as "[t]he offense of frequently exciting and stirring up quarrels and suits, either at law or otherwise," *id.* at 137; *see* Francis & Johnson, *supra* note 9, at 222.

[12] Radin, *supra* note 9, at 57-58. Many of the early Christians in England believed that participation in lawsuits marked an inclination to quarrel that was inconsistent with the Christian spirit of forgiveness. *Id.* at 58. As a result, the adversary character of the lawsuit was viewed as unchristian and possibly evil. *Id.* at 72.

[13] In the early days of the English legal system, the few persons who did enter the legal profession were predominantly from wealthy backgrounds. R. POUND, THE LAWYER FROM ANTIQUITY TO MODERN TIMES 100 (1953); *see also* Agate, *Legal Advertising and the Public Interest*, 50 L.A. B. BULL. 209, 209 (1975) (effect of early English legal history on attorney advertising restrictions).

The expense involved in obtaining a legal education was extremely high, and the cost prohibited persons with common backgrounds from studying law. H. COHEN, A HISTORY OF THE ENGLISH BAR 500-01 (1929). Occasionally, merchants would liquidate some of their capital so as to finance their sons' legal education. *Id.* at 501.

In general, lawyers considered themselves to be performing a public service rather than earning a living. H. DRINKER, LEGAL ETHICS 210 (1953). This view led to a form of dignity and aloofness that the legal profession has attempted to preserve. Drinker states that "[a] duty of public service, of which the emolument is a by-product, and in which one may attain the highest eminence without making much money" is one of the primary distinctions between the practice of law and employment in a business. *Id.* at 5.

The principles of legal education that developed in England discouraged any manner of competition between barristers. *Id.* at 210. Students seeking to enter the legal profession came to the Inns of Court to study. *Id.* The four Inns of Court controlled the education of all barristers admitted to the English bar. R. POUND, *supra*, at 87. These Inns were similar to select fraternities, and all barristers lived and worked together on a friendly basis. H. DRINKER, *supra*, at 210. As a result of this sense of brotherhood, members of the legal profession scorned any competition within their ranks. *Id.*

[14] H. DRINKER, *supra* note 13, at 210. Because lawyers were from affluent backgrounds, they had no respect for activities such as advertising and considered it an undignified practice. *Id.* In addition, the belief was widely held that if lawyers were to advertise, the image of the legal profession as a whole would be damaged. M. FREEDMAN, LAWYER'S ETHICS IN AN ADVERSARY SYSTEM 115 (1975).

[15] A. KAUFMAN, PROBLEMS IN PROFESSIONAL RESPONSIBILITY 29 (1976).

[16] Francis & Johnson, *supra* note 9, at 226. This code of ethics was based upon a series of lectures by Judge George Sharswood and provided for the regulation but not the prohibition of attorney advertising. *Id.*

adopted by the American Bar Association in 1908.[17] Of these original forty-seven Canons of Ethics, Canon 27 dealt most directly with advertising.[18] This canon prohibited almost all types of attorney advertising.[19]

The Canons of Ethics were amended several times to correct their weaknesses, and in 1969 the ABA adopted a new set of rules titled the Code of Professional Responsibility.[20] Canon 2[21] of this code deals with advertising by attorneys, and the Disciplinary Rules that accompany Canon 2 have had the effect, until recent years, of continuing to strictly prohibit almost all forms of attorney advertising.[22] The United

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[17] A. KAUFMAN, *supra* note 15, at 29.

[18] Francis & Johnson, *supra* note 9, at 226. The original Canon 27 provided: "The most worthy and effective advertisement possible, even for a young lawyer, and especially for his brother lawyers, is the establishment of a well merited reputation for professional capacity and fidelity to trust. This cannot be forced, but must be the outcome of character and conduct." CANONS OF PROFESSIONAL ETHICS No. 27 (1908).

[19] CANONS OF PROFESSIONAL ETHICS No. 27 (1908). The prohibition included "circulars, advertisements, through [the use of] touters, or by personal communications or interviews not warranted by personal relations." *Id.* These original canons were very short and served as general rules. A. KAUFMAN, *supra* note 15, at 28-29. Because of their generality, they often did not provide solutions for lawyers attempting to deal with specific situations. *Id.* at 29.

[20] A. KAUFMAN, *supra* note 15, at 28-30. All the states have adopted this code after making changes in various rules. *Id.* at 29.

[21] MODEL CODE OF PROFESSIONAL RESPONSIBILITY Canon 2 (1980). This canon provides, "A lawyer should assist the legal profession in fulfilling its duty to make legal counsel available." *Id.*

[22] Meyer & Smith, *Attorney Advertising: Bates and a Beginning*, 20 ARIZ. L. REV. 427, 430-31 (1978). As will be shown below, recent Supreme Court decisions indicate a liberalization of restrictions in this area. *See infra* notes 24-29 and accompanying text. In addition, the Model Code of Professional Responsibility has provided exceptions to its prohibition of attorney advertising by allowing the name, address, and telephone number of a lawyer, in addition to certain specific facts, such as whether he is certified as a specialist in a certain field, to be listed on professional cards (DR 2-102[A][1]), announcement cards (DR 2-102[A][2]), office signs (DR 2-102[A][3]), and letterhead stationery (DR 2-102[A][4]). MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 2-102[A] (1980).

The Disciplinary Rules provided in Canon 2 are a response to four traditional concerns. The first concern is that advertising by attorneys might increase the occurrence of fraudulent activities in transactions between attorneys and clients. Note, *Advertising, Solicitation and the Profession's Duty to Make Legal Counsel Available*, 81 YALE L.J. 1181, 1187 (1972).

Secondly, it has traditionally been feared that advertising by attorneys would increase the amount of unnecessary litigation. *Id.* at 1188-89; *see, e.g.*, Holloway v. Lowe, 7 Port. 488, 491 (Ala. 1838); *In re* Davidson, 64 Nev. 514, 186 P.2d 354, 359 (1947).

The third concern is that advertising could harm the dignity of the profession. Note, *supra*, at 1189-90; *see also* M. FREEDMAN, *supra* note 14, at 115 (effect of advertising on

States Supreme Court has indicated that the Disciplinary Rules following Canon 2, when construed as prohibiting all forms of advertising, are more restrictive than the first amendment will allow.[23]

Before the adoption of the original Model Code of Professional Responsibility in 1969, the Supreme Court recognized the constitutional significance of protecting the consumer's right to a free flow of information.[24] As this right became more firmly established, there ensued an extension of first amendment protection to commercial forms of speech[25] and, consequently, a liberalization of the Supreme Court's

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public's opinion of legal system).

The final concern underlying the Disciplinary Rules is that advertising might cause lawyers to be chosen by clients based on the effectiveness of their advertisements rather than their legal abilities. State v. Nichols, 151 So. 2d 257, 268 (Fla. 1963); *see also* Note, *supra*, at 1184-85 (discussing undesirable consequences of easing advertising restrictions).

[23] *See infra* note 35.

[24] In 1963, the Supreme Court decided the case of NAACP v. Button, 371 U.S. 415 (1963), in which it held that the solicitation of clients by attorneys motivated by political beliefs could not be prohibited under the first and fourteenth amendments. *Id.* at 428-30. The first amendment provides, "Congress shall make no law . . . abridging the freedom of speech, or of the press." U.S. CONST. amend. I. The fourteenth amendment provides in pertinent part:

> No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

U. S. CONST. amend. XIV, § 1. *See generally* Schneider v. State, 308 U.S. 147, 160 (1939) (first amendment freedoms of speech and press are secured by fourteenth amendment against breaches by state); Gitlow v. New York, 268 U.S. 652, 666 (1925) (first amendment is applicable to states through fourteenth amendment).

The *Button* case involved attempts by NAACP lawyers to convince parents of children enrolled in segregated schools to permit the NAACP to bring desegregation suits in their names. 371 U.S. at 421. When efforts were made to stop these attempts, the NAACP brought an action claiming that the state's rules against solicitation were unconstitutional. *Id.* at 417-19. The Court held that the actions of the NAACP were a method of "political expression" and that since the lawyers soliciting the parents had no financial interest in the suits, *id.* at 443, and because the clients were not charged attorneys fees, *id.* at 420, these activities were entitled to constitutional protection, *id.* at 428-30. In addition, the *Button* Court held that when the activity is one entitled to first amendment protection, the state has the burden of showing a substantial regulatory interest justifying the relevant prohibition. *Id.* at 444.

The Court extended this first amendment protection in Brotherhood of R.R. Trainmen v. Virginia *ex rel.* Va. State Bar, 377 U.S. 1 (1964), where it held that a union had the right to recommend attorneys to its members and to advise the members as to when an attorney might be needed. *Id.* at 8. In this case, the Court ruled that the state must show an appreciable public interest to justify prohibiting the solicitation. *Id.* at 7-8.

[25] *See* Virginia State Bd. of Pharmacy v. Virginia Citizens Consumer Council, Inc.,

view of attorney advertising.[26] Through its decisions between 1963 and

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425 U.S. 748, 758-65 (1976). In *Virginia State Bd. of Pharmacy*, the Supreme Court modified the doctrine of commercial speech. Meyer & Smith, *supra* note 22, at 444. This doctrine, which was first developed in Valentine v. Chrestensen, 316 U.S. 52 (1942), says that the state's exercise of control over commercial forms of speech does not infringe upon a person's first amendment rights and, therefore, is not unconstitutional. *Id.* at 53-55. The *Virginia State Bd. of Pharmacy* decision modified this doctrine by finding a statute that prohibited pharmacists from advertising prescription drugs to be a violation of the first amendment. 425 U.S. at 770-73.

The holding in the *Virginia State Bd. of Pharmacy* case extended first amendment protection to product advertising. *Id.* at 763-65. Three reasons were given for this extension. First, a "free flow of commercial information" in regard to price advertising might affect the lives of consumers as much as important political decisions. *Id.* at 763. Second, if the range of choices available to consumers were widened, the allocation of our resources would be improved. *Id.* at 765. Third, advertising assists people in forming opinions as to how well our economic system operates. *Id.; see also* Louisiana Consumer's League v. Louisiana State Bd. of Optometry Examiners, 557 F.2d 473, 474-75 (5th Cir. 1977) (statute prohibiting price advertising of prescription eyeglasses unconstitutional); Horner-Rausch Optical Co. v. Ashley, 547 S.W.2d 577, 579 (Tenn. 1976) (same). *See generally* Meyer & Smith, *supra* note 22, at 443-45 (discussing development and modification of commercial speech doctrine in regard to attorney advertising).

In the *Virginia State Bd. of Pharmacy* case, the Court clearly stated, however, that commercial speech which is false or misleading is outside the protection of the Constitution and may be prohibited by the states. 425 U.S. at 771; *see* Eaton v. Supreme Court, 607 S.W.2d 55, 59-61 (Ark. 1980); Florida Bar v. Kaiser, 397 So. 2d 1132, 1133-34 (Fla. 1981); *see also* McWhorter v. State Bd. of Registration, 359 So. 2d 769, 774 (Ala. 1978) (statute prohibiting use of misleading trade name held constitutional). *See generally* Gertz v. Robert Welch, Inc., 418 U.S. 323, 340 (1974) (there is no constitutional value in false statements of fact); Konigsberg v. State Bar, 366 U.S. 36, 49 n.10 (1961) (first amendment right of freedom of speech is not absolute).

[26] This liberalization of the Supreme Court's view of attorney advertising can be seen in the Court's decision in Goldfarb v. Virginia State Bar, 421 U.S. 773 (1975), where it recognized services rendered in the legal profession as "commerce." *Id.* at 786-88. The Court held that the bar association's regulation establishing minimum fees for services violated the Sherman Anti-Trust Act, 15 U.S.C. § 1 (1976). 421 U.S. at 792-93. The Court did not deal directly with the issue of attorney advertising. By labeling services performed by lawyers for payment as commerce, however, the Court significantly altered the attitude of the judiciary toward the legal profession. *See* Note, *Attorney Solicitation of Clients: Proposed Solutions*, 7 HOFSTRA L. REV. 755, 761-63 (1979).

Later, in Bigelow v. Virginia, 421 U.S. 809 (1975), a case not specifically dealing with attorney advertising, the Court again applied a rule similar to the one enunciated in NAACP v. Button, 371 U.S. at 444, that there must be a legitimate public interest involved that outweighs the person's first amendment rights before the state may regulate advertising. 421 U.S. at 826. The Court stated that "[r]egardless of the particular label asserted by the State—whether it calls speech 'commercial' or 'commercial advertising' or 'solicitation'—a court may not escape the task of assessing the First Amendment interest at stake and weighing it against the public interest allegedly served by the regulation." *Id.*

1976,[27] the Court acknowledged that commercial speech in the form of attorney advertising is entitled to some degree of first amendment protection. Until *Bates v. State Bar of Arizona*,[28] however, the effect of this newly established constitutional protection on the Disciplinary Rules that accompany Canon 2 of the Code of Professional Responsibility was uncertain.

Bates, the most significant case in this area since the adoption of the ABA's Model Code of Professional Responsibility, affirmed the public's constitutional right to a free flow of commercial information.[29] This case involved two members of the Arizona State Bar who violated an Arizona disciplinary rule[30] by publishing an advertisement in a local newspaper.[31] The Arizona Supreme Court held that the regulation prohibiting advertising was constitutional.[32] On appeal, the United States Supreme Court in effect applied a balancing test weighing the public's interest in receiving a free flow of information regarding legal

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[27] *See supra* notes 24-26.

[28] 433 U.S. 350 (1977).

[29] *Id.* at 363-65, 384. The holding in *Bates* is clearly distinguishable from the earlier cases establishing the constitutional right of the public to receive information. The *Bates* decision, like the decision in *Virginia State Bd. of Pharmacy*, 425 U.S. 748 (1976), illustrates the Supreme Court's recognition of the constitutional value of purely commercial forms of speech. 433 U.S. at 363, 365. The motive for the particular expressions involved in both *Bates* and *Virginia State Bd. of Pharmacy* was entirely pecuniary, *id.* at 354, 363, whereas in *Button* and its progeny the motive was political in nature; *see supra* note 24.

[30] 433 U.S. at 355. The two attorneys violated MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 2-101[B] (1976):

> A lawyer shall not publicize himself, or his partner, or associate, or any other lawyer affiliated with him or his firm, as a lawyer through newspaper or magazine advertisements, radio or television announcements, display advertisements in the city or telephone directories or other means of commercial publicity, nor shall he authorize or permit others to do so in his behalf.

[31] 433 U.S. at 354. In the advertisement, the lawyers offered "legal services at very reasonable fees" and gave the prices for several legal services. *Id.* The Arizona State Bar filed a complaint against the two attorneys, and they were found guilty of the violations. *In re* Bates, 113 Ariz. 394, 396, 555 P.2d 640, 642 (1976), *rev'd*, 433 U.S. 350 (1977).

[32] 555 P.2d at 643. The two defendants appealed to the Supreme Court of Arizona on two grounds. First, they argued that the state bar's restriction on advertising limited competition between lawyers and violated the Sherman Anti-Trust Act, 15 U.S.C. §§ 1-2 (1976). 555 P.2d at 642. To this argument the Arizona Supreme Court responded that "regulation of the State Bar by the Supreme Court is an activity of the State of Arizona acting as sovereign and exempt by the very provisions of the Sherman Act." *Id.* at 643.

Additionally, the defendants claimed that the restriction was in violation of the first amendment. *Id.* The Arizona court also rejected this argument and held that the rule was constitutional. *Id.*

services against the state's interest in regulating the legal profession.[33] Holding that restrictions can only be justified if the state's interests were substantial,[34] the Court concluded that the state's complete prohibition of advertising violated attorneys' first amendment rights.[35]

Although the Court in *Bates* did extend first amendment protection to attorney advertising, it stated that this protection is not absolute.[36] As a limitation on this protection, the Court emphasized that advertising that is "false, deceptive, or misleading"[37] may be completely prohibited by the states.[38] To prevent misleading advertisements, the *Bates* Court adopted the rule that only routine legal services could be appropriately advertised.[39]

Two significant cases subsequent to *Bates*, *In re Primus*[40] and *Ohralik v. Ohio State Bar*,[41] dealt with in-person solicitation rather than commercial advertising. In *In re Primus*, the Court concluded that when the actions of an attorney engaged in solicitation are politically motivated rather than financially motivated, the degree of protection afforded by the first amendment should be high,[42] implying that

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[33] 433 U.S. at 365, 372-79, 383-84; *see* Meyer & Smith, *supra* note 22, at 448. The Court found that the commercial speech doctrine could still be valid but could not be used to restrict consumers' interests. 433 U.S. at 363-64.

[34] 433 U.S. at 364-65.

[35] *Id.* at 384. In this 5-4 decision, Justice Blackmun, who delivered the majority opinion, stated:

> The constitutional issue in this case is only whether the State may prevent the publication in a newspaper of appellants' truthful advertisement concerning the availability and terms of routine legal services. We rule simply that the flow of such information may not be restrained, and we therefore hold the present application of the disciplinary rule against appellants to be violative of the First Amendment.

[36] *Id.* at 383.

[37] *Id.*

[38] *Id.* This limitation had been previously announced in Virginia State Bd. of Pharmacy v. Virginia Citizens Consumer Council, Inc., 425 U.S. 748, 771-72 (1976).

[39] 433 U.S. at 372. The Court listed uncontested divorce, simple adoption, uncontested personal bankruptcy, and change of name as examples of routine legal services. *Id.*

[40] 436 U.S. 412 (1978).

[41] 436 U.S. 447 (1978).

[42] 436 U.S. at 428. The Court dealt with the actions of an attorney who attempted to convince women who had been sterilized as a prerequisite to their receipt of financial assistance through Medicaid to allow the ACLU to represent them free of charge. *Id.* at 415-16. The defendant in this case was to receive no compensation for his services. *Id.* at 428-29; *see supra* note 24 and accompanying text; *cf.* United Transp. Union v. State Bar, 401 U.S. 576, 585 (1971) (upholding right of group to secure meaningful access to courts); United Mine Workers, Dist. 12 v. Illinois State Bar Ass'n, 389 U.S. 217, 223-25 (1967) (establishing union's right to assist its members in asserting legal rights); Brotherhood of

regulation of these actions must be minimal.[43] In *Ohralik,* the Court found that regulation by the bar association is proper when the in-person solicitation is made for monetary gain.[44] The principal distinction between these two holdings hinges on the motivation for the solicitation made by the defendants and the potential for harm to the prospective client based on the solicitation.[45] Where the attorney's motivation is financial gain,[46] as in *Ohralik,* the Supreme Court has not extended first amendment protection as far as it has in situations when the motivation is the advancement of beliefs and ideas.[47] Consequently, more state regulation has been permitted in the former type of case than in the latter.[48]

The *Ohralik* Court drew a distinction between its holding and the holding in *Bates.*[49] This distinction was based upon the different modes of communication involved.[50] A newspaper advertisement, such as the one in *Bates,* simply conveys information and allows the reader

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R.R. Trainmen v. Virginia *ex rel.* Va. State Bar, 377 U.S. 1, 8 (1964) (upholding right of union to advise members when to obtain legal assistance and to recommend lawyers).

[43] The Court stated, "Where political expression or association is at issue, this Court has not tolerated the degree of imprecision that often characterizes government regulation of the conduct of commercial affairs." 436 U.S. at 434.

[44] *Id.* at 464. The defendant in this case attempted to solicit two injured accident victims in order to represent them. *Id.* at 449-51. The defendant obtained the consent of both women but was later discharged. *Id.* at 451-52. A complaint regarding the defendant's practices was filed with the Ohio State Bar Association, *id.* at 452-53, and he was found to have violated OHIO CODE OF PROFESSIONAL RESPONSIBILITY DR 2-103[A], 2-104[A] (1970). DR 2-103[A] provides, "A lawyer shall not recommend employment, as a private practitioner, of himself, his partner, or associate to a non-lawyer who has not sought his advice regarding employment of a lawyer;" and DR 2-104[A] provides, "A lawyer who has given unsolicited advice to a layman that he should obtain counsel or take legal action shall not accept employment resulting from that advice," unless the person is a "close friend, relative, former client (if the advice is germane to the former employment), or one whom the lawyer reasonably believes to be a client." *Id.* DR 2-103[A], 2-104[A] (1970), *quoted in Ohralik,* 436 U.S. at 453 n.9.

In upholding these Disciplinary Rules, the United States Supreme Court ruled that it was within the limits of the Constitution for a bar association to regulate solicitations by attorneys for compensation. 436 U.S. at 464-68.

[45] *Ohralik,* 436 U.S. at 454, 470-71; *see Primus,* 436 U.S. at 438 n.32 (discussing distinction between motivation for solicitations made in *Primus* and *Ohralik*).

[46] Where the motivation is pecuniary, that is, where commercial speech is involved, the speech may take the form of media advertising, *see supra* note 35, or in-person solicitation, *see supra* note 44.

[47] "In the context of political expression and association, . . . a State must regulate with significantly greater precision." 436 U.S. at 437-38.

[48] *Id.* at 456.

[49] *Id.* at 457-59.

[50] *Id.*

to choose whether to act upon it. In-person solicitation may not provide the consumer with the same freedom of choice.[51]

Since the *Bates* case in 1977 and the *Ohralik* case in 1978, several courts have applied the basic rule of *Bates*[52] to other forms of attorney-related commercial speech.[53] In *Kentucky Bar Association v. Stuart*,[54] the Supreme Court of Kentucky was faced with the issue of whether mailing letters to solicit clients should be given the same constitutional consideration as in-person solicitation.[55] The court reasoned that because the letters were a form of advertisement rather than a form of solicitation,[56] and because the dangers attendant to in-person solicitation were absent,[57] direct mail advertising was entitled to constitutional protection.[58]

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[51] *Id.* at 457-58.

[52] *See supra* notes 33-35 and accompanying text.

[53] In a concurring opinion in *Bates*, Justice Powell stated, "The Court speaks specifically only of newspaper advertising, but it is clear that today's decision cannot be confined on a principled basis to price advertisements in newspapers. No distinction can be drawn between newspapers and a rather broad spectrum of other means. . . ." 433 U.S. at 402 n.12; *see, e.g.*, Kentucky Bar Ass'n v. Stuart, 568 S.W.2d 933, 934 (Ky. 1978) (per curiam) (permitting direct mail advertising by attorneys); Koffler v. Joint Bar Ass'n, 51 N.Y.2d 140, 412 N.E.2d 927, 929, 432 N.Y.S.2d 872, 873 (1980) (same), *cert. denied*, 450 U.S. 1026 (1981); *In re* Petition for Rule of Court Governing Lawyer Advertising, 564 S.W.2d 638, 643-44 (Tenn. 1978) (permitting attorney advertising through electronic broadcast media).

[54] 568 S.W.2d 933 (Ky. 1978) (per curiam).

[55] *Id.* at 933-34. A complaint had been filed against two attorneys for violating CODE OF PROFESSIONAL RESPONSIBILITY DR 2-103[A] (1977), which prohibits attorneys from recommending themselves for employment. The lawyers had mailed letters to two real estate agencies informing them of several legal services available and the fees charged for each. 568 S.W.2d at 933. The case was first heard by the Trial Committee of the Kentucky State Bar Association, which found that DR 2-103[A] had been violated; the Board of Governors of the Kentucky Bar Association agreed, holding that the letters amounted to in-person solicitation. *Id.* The case was then appealed to the Supreme Court of Kentucky. *Id.*

[56] 568 S.W.2d at 934.

[57] *Id.*

[58] *Id. But see* Eaton v. Supreme Court, 270 Ark. 573, 607 S.W.2d 55, 59-60, *cert. denied*, 450 U.S. 966 (1980).

The standard applied in assessing the degree of this constitutional protection was that stated earlier in *Bigelow, see supra* note 20, and *Bates, see supra* notes 33-35 and accompanying text. This standard involves weighing the state's interest in prohibiting the advertisement against first amendment protection of freedom of speech. 568 S.W.2d at 934.

The Supreme Court of Kentucky, in *Kentucky Bar Ass'n v. Stuart*, stated, "It is now beyond dispute that advertising by attorneys is constitutionally protected, unless the Association can justify prohibition of such speech by an interest which will outweigh

Following the *Kentucky Bar Association* case, the New York Court of Appeals decided *Koffler v. Joint Bar Association,*[59] a case similar to the Kentucky case both in its factual situation[60] and in its applicable disciplinary rule.[61] New York's court of last resort reversed the defendant's conviction for violating the rule.[62] In determining the constitutionality of the regulation, the court of appeals applied a four-part analysis[63] enunciated by the United States Supreme Court in *Central Hudson Gas & Electric Corp. v. Public Service Commission,*[64] an unrelated commercial speech case. This four-part test provides that a court should first determine whether the particular expression is entitled to first amendment protection.[65] To receive this protection, commercial forms of speech must involve lawful activity and must not be misleading.[66] Secondly, the court should determine whether the state's interest in regulating the expression is substantial.[67] Thirdly, the court should decide whether the regulation directly advances the interest asserted by the state.[68] Finally, the court should determine whether the regulation is more restrictive than necessary to protect the state's asserted interest.[69] The court of appeals found that solicitation of clients through the use of direct mail comes within the purview of "constitutionally protected commercial speech."[70] Therefore, it may not be completely prohibited, although it is subject to controls and limitations.[71]

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individual and societal interests in the commercial speech." *Id.* The Kentucky court held that in this instance the Kentucky Bar Association had not met this burden. *Id.*

[59] 51 N.Y.2d 140, 412 N.E.2d 927, 432 N.Y.S.2d 872 (1980), *cert. denied,* 450 U.S. 1026 (1981).

[60] As in the Kentucky case, the defendant in *Koffler* was found guilty of mailing solicitation letters to real estate agents. 51 N.Y.2d at 143, 412 N.E.2d at 929, 432 N.Y.S.2d at 874. The letters in *Kentucky Bar Ass'n* were sent to only two real estate agencies, *see supra* note 55, whereas in *Koffler,* they were sent to approximately 7500 property owners in addition to several real estate brokers. 51 N.Y.2d at 143, 412 N.E.2d at 929, 432 N.Y.S.2d at 874.

[61] NEW YORK CODE OF PROFESSIONAL RESPONSIBILITY DR 2-103[A] (1970) (adopted from MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 2-103[A] (1970)); *see supra* note 44).

[62] 51 N.Y.2d at 143, 412 N.E.2d at 929, 432 N.Y.S.2d at 873.

[63] *See id.* at 147, 412 N.E.2d at 932, 432 N.Y.S.2d at 876 (applying four-part analysis).

[64] 447 U.S. 557, 566 (1980).

[65] *Id.*

[66] *Id.*

[67] *Id.*

[68] *Id.*

[69] *Id.*

[70] 51 N.Y.2d at 143, 412 N.E.2d at 929, 432 N.Y.S.2d at 873.

[71] *Id.,* 412 N.E.2d at 929, 432 N.Y.S.2d at 873. The court of appeals found that the

The same constitutional protection extended to advertisements in newspapers and, to a lesser extent, direct mail advertisements,[72] was also extended to advertisements in telephone directories. In *Princeton Community Phone Book, Inc. v. Bate*,[73] the United States Court of Appeals for the Third Circuit considered an opinion, issued by the Supreme Court of New Jersey's Advisory Committee on Professional Ethics,[74] which had the effect of prohibiting lawyers from advertising in the plaintiff's telephone directory.[75] The Third Circuit applied the balancing rationale of *Bates*[76] and concluded that the advisory committee opinion's prohibition violated the first amendment.[77] The court rejected any contention that telephone directory advertisements should be treated differently from newspaper advertisements and held that both should receive the same degree of first amendment protection.[78]

In re R.M.J.[79] is the most recent case in which the United States Supreme Court reviewed the constitutionality of regulations that prohibit attorney advertising. This case involved an attorney who was found guilty of violating two Disciplinary Rules of the State of Missouri.[80] On appeal, the United States Supreme Court reversed the

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bar association's prohibition of the use of direct mail in solicitation of potential clients did not meet the fourth part of the test in that the regulation was more restrictive than necessary to protect the state interest involved. *Id.* at 149-50, 412 N.E.2d at 933, 432 N.Y.S.2d at 877. Because a less restrictive regulation could protect the state's interest in efficient administration of justice, the bar association's rule was held unconstitutional. *Id.* at 151, 412 N.E.2d at 934, 432 N.Y.S.2d at 878-79.

[72] *See id.* at 149-50, 412 N.E.2d at 933, 432 N.Y.S.2d at 878 (holding that the potential for deception is greater with direct mail advertising).

[73] 582 F.2d 706 (3rd Cir.), *cert. denied*, 439 U.S. 966 (1978).

[74] New Jersey Supreme Court Advisory Comm. on Professional Ethics, Op. 290 (1974). The Advisory Committee opinion stated that "purchase of a classified listing in an advertising directory . . . is not ethically acceptable." 582 F.2d at 709 (quoting New Jersey Supreme Court Advisory Comm. on Professional Ethics, Op. 290 (1974)).

[75] 582 F.2d at 709-10. The opinions rendered by this committee are binding on local ethics committees. *Id.* at 708.

[76] *See supra* notes 33-35 and accompanying text.

[77] 582 F.2d at 711.

[78] *Id.* at 710-11.

[79] 102 S. Ct. 929 (1982). The attorney in this case, while attempting to establish a law practice, sent announcement cards to certain groups of people and published advertisements in the "Yellow Pages" of a local telphone directory. *Id.* at 934.

[80] *Id.* at 932-34. The first violation involved DR 2-102[A][2], which provided that an attorney may send out a "brief professional announcement card stating new or changed associates or addresses, change of firm name, or similar matters," but only to "lawyers, clients, former clients, personal friends, and relatives." MISSOURI CODE OF PROFESSIONAL RESPONSIBILITY DR 2-102[A][2] (1982). The defendant sent announcement cards to persons who were not included in the categories provided for in DR 2-102[A][2]. 102 S. Ct.

lower court's decision and held that the relevant sections of the Missouri Disciplinary Rules were unconstitutional.[81] The Court briefly outlined the status of the doctrine of commercial speech, reiterating that first amendment protection extends to advertisements that are not false, misleading, or related to illegal activities.[82] Advertisements that are misleading may be constitutionally prohibited;[83] however, a state does not have the power to completely prohibit the publication of certain information solely on the ground that it is "potentially misleading."[84] The Court followed the earlier established rule that in order for the state to restrict advertising that is not misleading, the state must prove a substantial interest in regulating the speech involved.[85] Applying the fourth part of the *Central Hudson Gas & Electric Corp. v. Public Service Commission*[86] analysis,[87] the Court held that any re-

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at 934.

The second violation involved DR 2-101[B], which provided that an attorney may publish any of ten specified items in the "Yellow Pages" of a telephone directory: "name, address and telephone number; areas of practice; date and place of birth; schools attended; foreign language ability; office hours; fee for initial consultation; availability of a schedule of fees; credit arrangements; and the fixed fee to be charged for certain specified 'routine' legal services." 102 S. Ct. 932-33 (citing MISSOURI CODE OF PROFESSIONAL RESPONSIBILITY DR 2-101[B] (1982)).

The Advisory Committee, a committee authorized by the Supreme Court of Missouri to institute disciplinary proceedings and give opinions on the state's Rules of Professional Responsibility, found the defendant's telephone directory advertisements to be a violation of DR 2-101[B] on three grounds. First, the advertisement stated the jurisdiction in which the defendant was licensed to practice law and that he had been "admitted to practice before the United States Supreme Court," two items that were neither expressly prohibited nor allowed by Missouri's Disciplinary Rules. 102 S. Ct. at 934. Secondly, the advertisements described what services were offered using names that were different from those listed in the disciplinary rules. *Id.* Thirdly, in all but one of the advertisements published, the defendant did not include a "required disclaimer" stating that he was not certified as an expert in the subjects listed. *Id.* The Supreme Court of Missouri affirmed the Committee's decision and held that the disciplinary rules were constitutional. *In re* R.M.J., 609 S.W.2d 411, 412 (Mo. 1981), *rev'd*, 102 S. Ct. 929 (1982).

[81] 102 S. Ct. at 929.

[82] *Id.* at 937.

[83] *Id.* In addition to completely prohibiting "inherently misleading" advertisements, the Court held that "when the particular content or method of the advertising suggests that it is inherently misleading or when experience has proven that in fact such advertising is subject to abuse, the states may impose appropriate restrictions." *Id.*

[84] *Id.* The Court referred to the list of services offered in defendant's advertisements and found that even though this information might be potentially misleading, if it could be conveyed to the recipient of the advertisement in a manner that is not deceptive, it may not be prohibited. *Id.*

[85] *Id.* at 937-38.

[86] 447 U.S. 557 (1980).

strictions in this area must be specific and may be imposed "only to the extent regulation furthers the state's substantial interest."[88] The Court also pointed out that in addition to misleading advertising, there may be other situations that demand control or restrictions,[89] but that complete prohibition of attorney advertising, without proof that the advertising is misleading, is forbidden by the first and fourteenth amendments.[90]

In the instant case, the court reasoned that the United States Supreme Court holdings in *Bates v. State Bar of Arizona*[91] and *In re R.M.J.*[92] provide only for the regulation of advertisements that are inherently misleading or deceptive, or have proven to be deceptive in the past.[93] Since it has been established that a bar association may not impose a general condemnation of all advertisements,[94] a complete pro-

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[87] *See supra* note 69 and accompanying text.

[88] 102 S. Ct. at 937-38. The Court referred to the four-step process enunciated in *Central Hudson Gas & Electric Corp.*, 447 U.S. at 566, *see supra* text accompanying notes 65-69, and distinguished between advertisements related to "professional services" and those related to "standardized products." 102 S. Ct. at 937 n.15. The Court pointed out that deception and confusion are more likely to result in regard to professional services, implying that these types of advertisements would be more appropriate for regulation and control. *Id.*

Under the particular circumstances of *In re R.M.J.*, the Court unanimously concluded that the state had not shown that a substantial interest was being maintained by the restriction and, therefore, the restriction upon the defendant's "Yellow Pages" advertisements was not constitutionally permissible. *Id.* at 938.

[89] 102 S. Ct. at 939. The Court concluded that the first and fourteenth amendments establish limitations upon the states' powers to regulate this form of commercial speech. This limitation is that such restrictions be made "with care and in a manner no more extensive than reasonably necessary to further substantial interests." *Id.*

[90] *Id.*

[91] 433 U.S. 350 (1977).

[92] 102 S. Ct. 929 (1982).

[93] McLellan v. Mississippi State Bar Ass'n, 413 So. 2d 705, 708 (Miss. 1982). The *McLellan* court relied on the rule stated in both *Bates* and *R.M.J.* that false, deceptive, or misleading advertisements are not constitutionally protected and, therefore, may be prohibited by the states. *See supra* notes 37-38, 82-83, and accompanying text.

The Mississippi Supreme Court, quoting from the opinion in *R.M.J.*, stated, "There may be other substantial state interests as well that will support carefully drawn restrictions." 413 So. 2d at 708 (quoting *In re* R.M.J., 102 S. Ct. 929, 939 (1982)). However, the United States Supreme Court provided no guidelines as to what these interests might be, and the *McLellan* court did not directly address this issue.

[94] 413 So. 2d at 707. The Mississippi Supreme Court relied on the decision in *Bates*, 433 U.S. at 384, *see supra* note 35, holding that a bar association could not prohibit the publication of a newspaper advertisement by an attorney. 413 So. 2d at 707.

The *McLellan* court added, "Each case has to be examined, and must stand, on its own facts." *Id.* at 709.

hibition of attorney advertising in the "Yellow Pages" of a telephone directory[95] is not constitutionally permissible.[96] The court held that since a complete prohibition of telephone directory advertising is not permitted by the Constitution, the sections of the Code of Professional Responsibility that prohibit such advertisements are unconstitutional.[97] In conclusion, the court observed that all advertisements are designed to draw attention to the persons publishing them and determined that the defendant's advertisement was not self-laudatory.[98]

The holding in the instant case is in accord with the United States Supreme Court's current trend in expanding the purview of constitutional protection in this area. This trend developed as a result of the Supreme Court's determination that commercial advertising by attorneys constitutes a form of speech protected by the first amendment.[99] This determination is indicative of a significant shift in attitudes toward attorney advertising, and possibly toward the role of the attorney in our society.[100] If this trend continues, the need for specific guidelines that the lower court and ethics committees can utilize in deciding cases of this nature will become even more important.

The Mississippi Supreme Court correctly applied the established rules to the factual situation present in *McLellan*.[101] The court, however, failed to resolve several important issues regarding attorney advertising. First, the *McLellan* court relied on the rule enunciated in both *Bates* and *R.M.J.* that advertisements that are inherently misleading or likely to be misleading are not protected by the Constitution and may be prohibited by the state.[102] Unfortunately, the court did not

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[95] The court found that the Complaint Tribunal's application of the relevant disciplinary rules, *see supra* notes 5, 8 and accompanying text, constituted a complete prohibition of advertisements published by attorneys in the "Yellow Pages" of a telephone directory. 413 So. 2d at 706, 708.

[96] 413 So.2d at 708. The Mississippi Supreme Court applied the holding in Princeton Community Phone Book, Inc. v. Bate, 582 F.2d 706, 710-11 (3rd Cir.), *cert. denied*, 439 U.S. 966 (1978), extending to advertisements published in telephone directories the same degree of first amendment protection given newspaper advertisements. 413 So. 2d at 707.

[97] 413 So. 2d at 708.

[98] *Id.* at 708-09. The court made this determination by comparing the advertisement in the instant case to those interpreted in Bates v. State Bar, 433 U.S. 350 (1977), and *In re* R.M.J., 102 S. Ct. 929 (1982). 413 So. 2d at 708-09.

[99] *See supra* notes 25, 35, and accompanying text.

[100] Recall, for example, the discussion of the strong attitudes that inhibited early lawyers from competing as well as from advertising. *See supra* notes 13-16 and accompanying text.

[101] 413 So. 2d at 708.

[102] *Id.; see supra* notes 25, 37, 38, 83, and accompanying text.

attempt to establish parameters for advertising that is likely to be misleading. In addition, the Mississippi Supreme Court quoted language from *R.M.J.* that established that the first and fourteenth amendments require that the states regulate commercial speech in a careful and precise manner and only to the extent necessary to protect substantial state interests;[103] yet, the *McLellan* court failed to provide guidelines for the bar association to follow in regulating attorney advertising.

Similarly, the *McLellan* court omitted any application of the *Central Hudson* analysis.[104] Because the fourth part of this analysis deals with the extent to which the state can regulate commercial speech,[105] use of this analysis would have provided the Mississippi Supreme Court with an opportunity to delineate acceptable, less restrictive means of regulating attorney advertising. Finally, the *McLellan* court reiterated the rule stated in *R.M.J.* that there may be other important state interests that demand control or restrictions;[106] however, the court did not provide specific examples of other state interests that would justify a complete prohibition of an advertisement such as the one in the instant case.

The Mississippi Supreme Court did not address these issues, but intimated that case-by-case determinations would be made to resolve attorney advertising issues.[107] Ultimately, the resolution of these issues will require a redrafting of the Mississippi Code of Professional Responsibility so that the disciplinary rules will be in accord with the contemporary limits of first amendment protection. Indeed, the decision in *McLellan* may precipitate such a redrafting. Before any significant changes can be made in this regard the Mississippi Supreme Court should provide guidance in the form of precisely reasoned decisions. In spite of the weaknesses of *McLellan,* the Mississippi Supreme Court has provided impetus for reforming the traditional attitudes toward advertising by members of the legal profession.

William Mendenhall

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[103] 413 So. 2d at 708 (citing *In re* R.M.J., 102 S. Ct. 929, 939 (1982)).

[104] *See supra* notes 64-69 and accompanying text.

[105] *See supra* note 69 and accompanying text.

[106] 413 So. 2d at 708 (citing *In re* R.M.J., 102 S. Ct. 929, 939 (1982)).

[107] 413 So. 2d at 709; *see supra* note 94.

BOOK REVIEW

THE HONOR AND DIGNITY OF THE PROFESSION: A HISTORY OF THE MISSISSIPPI STATE BAR, 1906-1976

By: Michael de L. Landon
Jackson, Mississippi: University Press of Mississippi, 1979
Pp. 195 $17.00

*Luther T. Munford**

The Mississippi State Bar long ago lost its amateur poet laureate, but it has engaged a professional historian, University of Mississippi Professor Michael de L. Landon, to chronicle the bar's modern history. Although shackled to a degree by the unspoken constraints on any "official" historian, Landon's *The Honor and Dignity of the Profession* renders an admirable service by cogently surveying the bar's seventy years of noble service, occasionally ignoble politicking, and frequent good humor.

As an example of the latter, Landon records that the alcoholic pun on the name "bar" was identified with the association as early as its organizational meeting in 1906. In that year, leaders in the state legal profession gathered in Jackson to organize a state counterpart to the American Bar Association that had been in existence since 1878. Mississippi lawyers formed a bar association in 1821 and again in 1886, but both those associations died after a few years of activity. Landon says the leaders in 1906 had many motives, including a desire to remedy a defective code adopted by the legislature in 1904 and to promote higher professional and ethical standards in the bar. Legislation adopted in 1906 permitted the bar association to prosecute an attorney for disbarment. Another motive for organization was to

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* Attorney, Butler, Snow, O'Mara, Stevens & Cannada, Jackson, Mississippi. A.B., 1971, Princeton University; B.A., 1973, Oxford University; J.D., 1976, University of Virginia.

keep up with the forty-five other states whose bars had similarly organized. Yet another was to provide a forum for the large plantation owners and other monied interests who felt threatened by the election of populist James K. Vardaman as Governor in 1903.

At its organizational meeting, the group of 207 lawyers elected as President, Dean Garvin D. Shands of the University of Mississippi Law School, a former two-term Lieutenant Governor. They also held a heated discussion concerning the location of the next meeting. The gathering chose Gulfport, as Landon notes, after an argument that "Gulfport with its many bars was a natural habitat of a Mississippi Bar Association." The pun scotched all opposition and the meeting was adjourned.

Landon's book, while it does not miss an opportunity for such humorous asides, has a more serious message, one that is particularly timely today when almost half of the lawyers practicing in the State of Mississippi are under the age of thirty-six. Landon identifies a long tradition, not just of conviviality, but also of contributions to the training of skilled lawyers, to the maintenance of high ethical standards, to the rendering of services to clients in need, and to the improvement of the system by which justice is administered in Mississippi. From Landon's perspective, such fundamental changes as the 1979 revision in the bar examination process and the adoption in 1981 of the Mississippi Rules of Civil Procedure stand as additional milestones in a long path already marked by historic accomplishments. To be sure, the tradition also includes occasional inappropriate forays into political battles irrelevant to the profession. Those skirmishes, embarrassing in retrospect, highlight by contrast the more lasting contributions the association has made both to justice in Mississippi and to the good humor of its members.

I. Training of Skilled Lawyers

Landon records, for example, that the association has long supported the University of Mississippi Law School in its efforts to train skilled lawyers. As early as 1925, an association committee lobbied the legislature for a new law school building. At that time, the law school was housed in what is now known as the

Geology building and the school had only one classroom. Though the 1926 legislature failed to appropriate the money, when the legislature returned in 1928 the association's efforts proved successful. Spurred on by the association and by a threat from the Association of American Law Schools to revoke the school's accreditation, the legislature voted the funds to build Lamar Hall, the new law school building.

Also in 1928, the association was responsible for the founding of the *Mississippi Law Journal.* In 1922, students at the law school had attempted to establish the "Mississippi Law Review," patterned after the law reviews published by Harvard, Yale, Virginia, and other prestigious schools, but they had not gained the support of practicing lawyers. In 1928, R.E. Wilbourn in his presidential address to the association suggested that the association itself publish the journal. Under the format proposed by Wilbourn and borrowed from Minnesota, the association and the university would issue a quarterly law review with the first issue each year to report the proceedings of that year's annual meeting of the association. The association contributed to the *Journal* the amount it had previously spent on printing its own proceedings, and a student editorial staff put out the *Journal* under supervision of the Dean.[1]

Just two months after the 1928 meeting adopted Wilbourn's proposal, issue number one of volume one of the *Mississippi Law Journal,* subtitled the "Journal *of the* State Bar Association," appeared. The Editor-in-Chief was Dugas Shands of Cleveland, and the Casenote Editor was John C. Satterfield of Port Gibson, a future president of both the Mississippi Bar (1955-1956) and the American Bar Association (1961-1962). By the late 1930's and early 1940's the state bar was spending approximately one-third of its annual budget as a subsidy to the *Law Journal.* This joint venture continued until 1981, when a mutual decision was made to cancel the subsidy and place the *Journal* on a subscription basis.

Some of the famous early articles in the *Mississippi Law Journal* concerned a controversy over bar examination stan-

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[1] *See generally* Landon, *The Origins of the Mississippi Law Journal,* 50 Miss. L.J. 1 (1979).

dards that had been generated by the association's Committee on Legal Education and Admission to the Bar. In 1928, the Committee suggested that candidates for the bar examination have at least two years of work in an accredited college or university and three years at an ABA or AALS approved law school. The Committee wanted to require that all members of the board of bar examiners have both a "literary" degree and a law degree from an accredited institution and suggested that the examiners keep complete records of the exams that would be available for public inspection in the Secretary of State's office.

These controversial ideas marked a fierce debate. Mississippi Supreme Court Justice George H. Ethridge, a self-taught lawyer, argued in the *Journal* that the suggestions were put forward by those who "want to exclude from the profession all who have not been born with a 'golden spoon' in their mouths, and who have a prejudice against self-educated men and women of the land,"[2] and concluded that the suggestions were "class legislation" that should be rejected.[3] In the same issue, Oxford attorney Phil Stone, a Yale graduate, argued in favor of the changes, saying that "[d]emocracies cannot afford to shun their experts, and cannot afford to have them badly trained."[4] The proposals never came to a vote as the depression brought on more pressing problems. Legislation was adopted in 1979, however, that enacted most of the elements of the 1928 proposal.[5]

The bar has also contributed to the education and training of lawyers after they have been admitted to practice. In 1962, a six man committee chaired by N.W. Overstreet, Jr. drew up plans for the Mississippi Bar Foundation, an independent corporation that dedicated itself to promoting legal research and teaching and to publishing and distributing literary works on legal subjects, one example of which is Landon's book. Among other accomplishments during its first fifteen years, the foundation published a history of the short-lived nineteenth century bar associations in Mississippi and a history of the Mississippi

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[2] Ethridge, *Unjust Standards for Law Practice*, 2 MISS. L.J. 276, 285 (1929).

[3] *Id.* at 277.

[4] Stone, *The Greatest Good for the Greatest Number*, 2 MISS. L.J. 286, 292 (1929).

[5] *See* MISS. CODE ANN. § 73-3-2 (Supp. 1981) (detailing requirements for admission to the bar).

Supreme Court from 1917 to 1948. Landon's book is dedicated to Overstreet.

In Landon's opinion, the creation in 1936 of the Junior Bar Section, now the Young Lawyer's Section, "may well have been the single most important event in the early history of the unified bar." He writes:

> Older lawyers for the most part, were inclined to be content with the *status quo* and not very willing to make changes or consider new ideas, and most younger ones were understandably reluctant to speak up in the presence of their elders, let alone argue with them. Now the younger members would have an official voice in the discussion of Bar business, and the opinions of the majority of them would be formally presented.

The section was organized by Hugh N. Clayton, L.O. Smith, Jr., W. Calvin Wells, Jr., and John C. Satterfield, all of whom were future leaders of the bar. Clayton was the first chairman of the Junior Bar Section.

The Young Lawyer's Section's most notable contribution to the training of lawyers has been the Mississippi Law Institute. Begun in 1946 to assist lawyers returning from the services to civilian practice, the institutes have continued annually.

II. Ethical Standards

From its inception the bar has served as the guardian of ethical standards of the state legal profession, and its history is replete with battles to preserve discipline among the profession. One such fray occurred in 1930, when the association voted to take steps to disbar nine attorneys. One of the accused was a Bay St. Louis attorney who was connected with Governor Theodore G. Bilbo's administration. He was accused of taking a bribe from Warren Brothers, an Ohio road building contractor, to have a suit pending against them dropped. The association took the unusual step of bringing the disbarment proceedings in the state supreme court, instead of the circuit or chancery court where the attorneys resided. In 1931, the proceedings ended in the disbarment of several of the accused attorneys and the acquittal of others, but the expense of the proceedings greatly strained the bar's budget. The association was then a voluntary

association and membership had dropped sharply as a result of the great depression. George Butler, the president in 1931, proposed to relieve the bar's treasury by supporting legislation requiring that all attorneys in the state, upon their admission to the bar, automatically become members of the association. The idea for a "unified bar" had first been accepted in North Dakota in 1921. The Mississippi Legislature adopted the concept in 1932, and the "Mississippi State Bar" as we know it today resulted.

In addition to its activities in disbarment proceedings, the bar has maintained since 1907 a Code of Professional Responsibility and, through its ethics committee, has rendered written ethics opinions for the guidance of Mississippi attorneys. As of April, 1982, seventy-three opinions had been issued.[6]

III. Services to Clients

The bar association has occasionally provided direct services to clients. In 1971, President William A. Bacon proposed to strengthen confidence in the legal profession by creating a fund from which persons who had lost money because of a lawyer's dishonesty could be reimbursed. In 1972, the Board of Commissioners gave their approval to the establishment of such a "client security fund."

The bar has also established a tradition of assistance to clients during disasters. For example, immediately following the Hurricane Camille devastation in August, 1969, the bar obtained an emergency grant of $50,000.00 from the Federal Office of Economic Opportunity and used it to equip and run a mobile law office for those who urgently needed assistance in putting their affairs back in order in the stricken counties. More than thirty lawyers from around the state volunteered their services for the program.

IV. Improving the System of Justice

The bar has played a significant and controversial role in

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[6] Ethics Comm. of the Mississippi State Bar, Op. 73 (Apr. 2, 1982), *reprinted in* Miss. Law., July-Aug. 1982, at 22, 22.

advocating reform of the justice system. At the association's first meeting, the bar heard a plea for raising judicial salaries and the hiring of stenographers to keep records of trials in chancery courts. The bar has championed the adoption of laws that would be uniform with the laws in other states, such as the Uniform Commercial Code adopted in 1966. As early as 1915, the association encouraged the legislature to pass a Uniform Negotiable Instruments Law, which was adopted by the legislature the following year. Less successful was the proposal of Chief Justice Sydney Smith who, in his presidential address at the 1915 meeting, championed the passage of a state "Judicature Act" that would have eliminated the distinction between circuit and chancery courts. Although hotly debated for a number of years, the proposal never found favor in the legislature.

The association successfully lobbied the legislature to pass the Chancery Practice Act in 1924. Authored by Virgil A. Griffith, the Act greatly simplified chancery court procedures and made them more flexible. The first edition of Griffith's famous treatise, *Mississippi Chancery Practice,* appeared the following year.

The association's campaign to adopt the Federal Rules of Civil Procedure for use in state courts began in 1943. The 1944 legislature rejected bills embodying the proposed changes. In 1947, the Junior Bar Section unanimously endorsed the legislation, which included a provision to change procedural rules. In a prophetic understatement, William C. Keady of Greenville remarked that if changing the rules were left up to the legislators, of which he was then one, it would take at least a generation before it would be done. Although the association at annual meetings in 1949, in 1950, and in 1951 approved procedural reform bills, these bills were rejected by the legislature. Not until 1981 did the state supreme court achieve the long-sought reform by asserting its constitutional power to adopt or revise rules without sanction from the legislature.

V. Good Humor

The bar's convivial purpose has also had a long history. If nothing else, the annual meetings have fixed at least one time during the year when every lawyer's trial calendar is empty. In

1908, the association resolved that, because their presence would "lend grace and dignity" to the annual meeting, members in the future were "invited to attend sessions accompanied by their wives, daughters, sisters, and sweethearts as the condition may then exist." Landon writes that in 1917, on a motion made by Leroy Percy and seconded by W.H. Powell of Canton, ladies for the first time were invited to attend the annual banquet. Landon dryly notes "one may presume that their presence thereafter resulted in a certain refining of the tone of the after dinner toasts and speeches." It took a long time before the passage of the prohibition statute in Mississippi in 1908 had any effect on the association banquet menus. As late as 1912, the banquet menu in Jackson offered Liebfraumilch to go with the softshell crabs and sauce tartare and Mumm's Extra Dry champagne. Not until 1916 was the association reduced to offering between the main course and the dessert a "punch au rhum," which Landon presumes was made up of fruit juices with artificial rum flavoring.

In 1936, W.A. Ellis of Carthage was invited, for the first time, to recite to the members a poem he had composed in honor of the host city, Greenville. He praised "the Delta's dearest queenliest queen," saying:

> None can surpass this magic town,
> None worthier of a noble crown,
> None pulls more cash and cotton down,
> Than Greenville by the river.

Through the years, Ellis continued to recite one or more poems specially written for the occasion at each annual meeting and in 1948 was formally commended for his "services as Poet Laureate." He died in 1950, and no new poet laureate was appointed to take his place. Landon views this lapse as a reflection on the decline in fashion of amateur poetry recitals brought on by the rise of television and radio.

Landon offers these worthwhile reflections on the changing customs of entertainment:

> An observer cannot help being struck by how much most of the entertainment provided at annual meetings by the mid-1960's and early 70's differed from that which the members of

> the Mississippi Bar had enjoyed back in the interwar years at meetings held in towns such as Greenwood, Laurel, Clarksdale, or Meridian. Such "down home-plain folks" amusements as horseshoe pitching and softball contests, movies, country club barbeques, and amateur concerts three decades later had lost their appeal for the sophisticated members of one of the *elite* professions in an increasingly prosperous "sunbelt" state. They enjoyed instead golf and tennis tournaments, fashion shows, exotic foods, and professional entertainers. Perhaps the amount of pleasure derived was no greater, but the change was certainly remarkable.

Landon reports that in the 1920's and 1930's welcoming speeches at opening ceremonies of the annual meetings nearly always contained broad hints that bootleg whisky would be readily available for all who wanted it, coupled with firm assurances that local law officers had orders not to bother roistering attorneys in their revels. At the 1972 annual meeting, however, the President of the Harrison County Bar Association warned his colleagues that the bar association did not enjoy immunity from arrest in Biloxi. Liquor had become legal, but the paradoxical result was that liquor laws and the laws against public drunkenness were being more strictly enforced.

VI. Political Thickets

Just as the bar has reflected changes in the social customs of Mississippi society, the bar too has occasionally let itself be drawn into political controversies that were outside the proper province of a professional association. Some causes have no doubt been worthy. The association denounced the hypocritical "black market tax" during prohibition, and in 1951 adopted a Junior Bar proposal that the state prohibition laws be abolished.

At the same time the bar has at times involved itself in political questions not directly related to the concerns of the legal profession and caused incidents that, in retrospect, are an embarrassment. In 1918, for example, the bar adopted a resolution urging that "only the lightest penalty" be imposed on an Army officer court-martialed in Arkansas for refusing to allow his company to be drilled alongside Negro troops. In 1922, the president of the association included in his presidential address praise for

the restrictive Alien Immigration Act of 1920 because of the alleged presence of socialists and anarchists among recent immigrants from Europe. Fewer than one-half of one percent of Mississippi residents in 1920 were foreign born. In 1950, the association adopted a resolution urging President Truman to discipline "very sternly" his Solicitor General for remarks he had made about labor law enforcement.

Such political commentary seems as out of place in a professional bar association as a vote for president would be in a jury trial. Because all lawyers must contribute dues to the unified bar, political stands may infringe the constitutional rights of members who disagree.[7] Some bar associations have reacted by banning politics altogether. For example, in a referendum passed in 1980, the District of Columbia Bar voted to limit the use of dues to discipline, admission and registration of attorneys, and a client security fund.

Landon's readable survey suggests that a bar association cannot shun politics altogether, because many of its most lasting contributions must come through legislation. The Mississippi Bar has needed legislation to get more tax money for the University of Mississippi Law School, to improve bar admissions standards and disciplinary procedures, and to gain many of its desired court reforms. Its failure to muster sufficient legislative support for the 1981 Rules has forced a constitutional crisis between the state supreme court and the legislature. A bar cannot afford to step out of the political arena, but it demeans itself by getting involved in issues that concern its members as citizens but not as professionals. The great contributions made by the bar have been contributions to the profession and to its members. The bar's attempts to intervene in other political matters have had little impact. As the bar selects its future agenda, it would do well to keep Landon's history, and the bar's most lasting purposes in mind.

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[7] *See* Lathrop v. Donohue, 367 U.S. 820, 877 (1961) (Black, J., dissenting) (state bar may not constitutionally require attorney to pay money to support political ideas he opposes); *cf.* Abood v. Detroit Bd. of Educ., 431 U.S. 209, 235-36 (1977) (Constitution mandates that funds expended by union for support of political ideas be derived from employees who do not disapprove of advancing the ideas).

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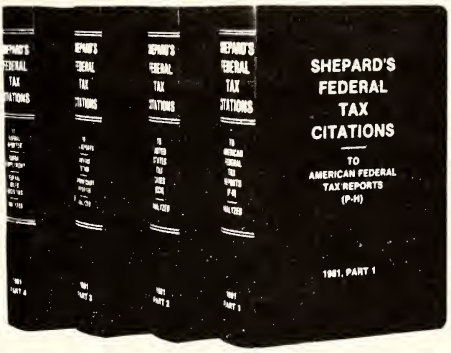

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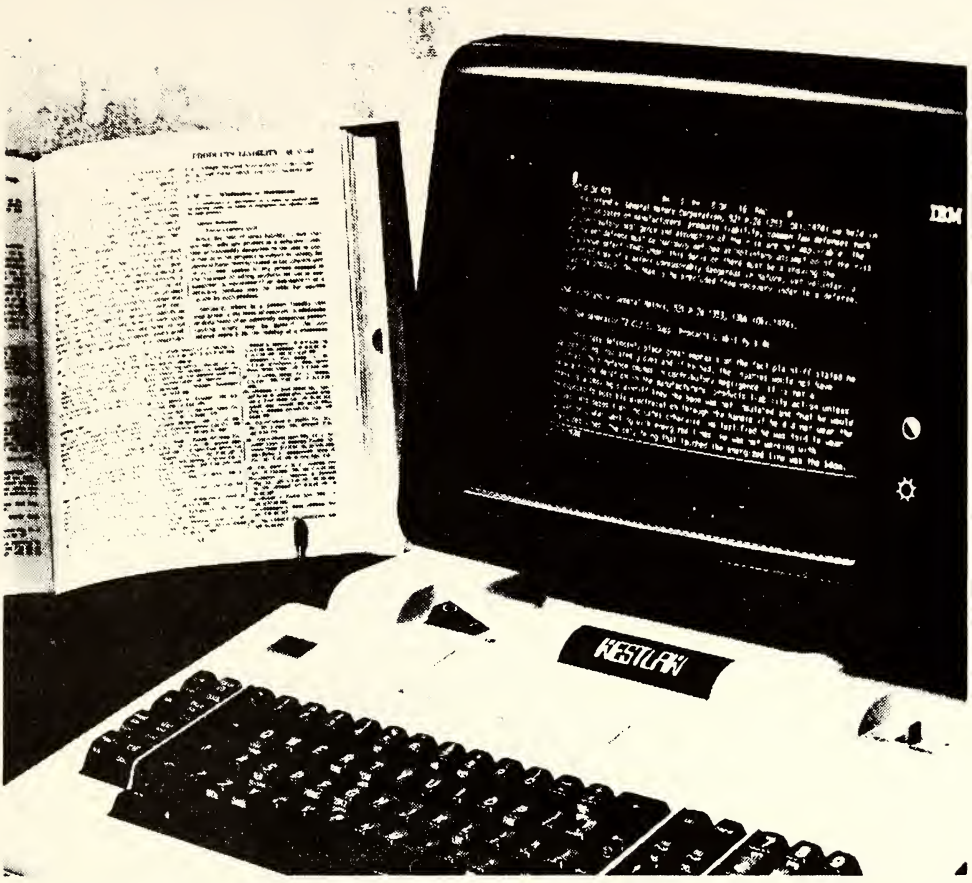

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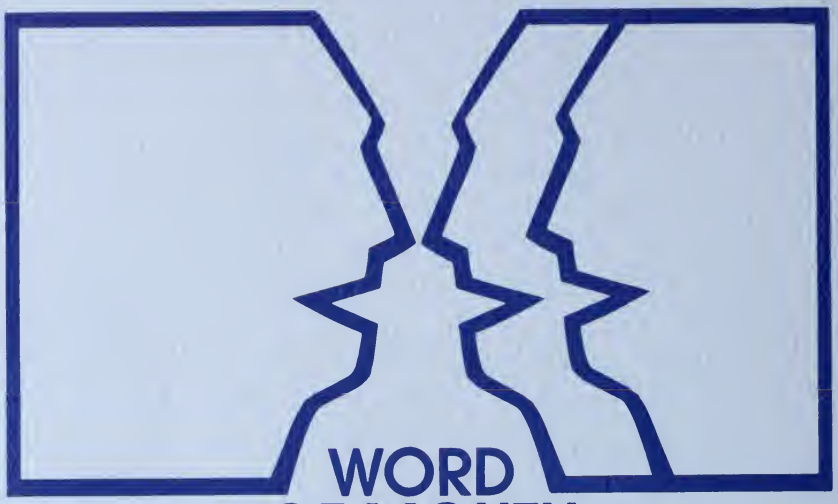

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